REPORT REFERENCE NO.	**RC/14/10**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**1 SEPTEMBER 2014**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2014 TO 2015 – QUARTER 1**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2014-2015 (to June) be noted.***
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a Code of Practice for Treasury Management. The Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing Best Practice in accordance with CIPFA's Code of Practice.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY RISKS AND BENEFITS ASSESSMENT	The contents of this report are considered compatible with current equalities and human rights legislation.
APPENDICES	Appendix A – Investments held as at 30 June 2014.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/14/3 – as approved at the meeting of the DSFRA meeting held on the 24 February 2014.

1. INTRODUCTION

1.1 The Treasury Management Strategy for Devon and Somerset FRA had been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) 2011 Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The most recent revision of the Code was adopted at the meeting of the DSFRA on the 18th February 2013. The Authority fully complies with the primary requirements of the Code, which includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities.
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives.
- The Receipt by the full Authority of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- The delegation by the authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

1.3 The preparation of this report demonstrates that the Authority is implementing best practice in accordance with the code.

2. ECONOMIC BACKGROUND

Economic performance

2.1 After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, and 0.8% in Q1 2014, it appears very likely that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, now broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. Accordingly, markets are expecting a first increase around the end of 2014.

2.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed in this quarter.

2.3 In June, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $35bn and are expected to stop by Q3 201, providing strong economic growth continues this year. First quarter GDP figures were depressed by exceptionally bad winter weather, but growth rates since then look as if they are recovering well.

2.4 The Eurozone is facing an increasing threat from deflation. In May, the inflation rate fell further, to reach 0.5%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the European Central Bank (ECB) did take some rather limited action in June to loosen monetary policy in order to promote growth.

Summary Outlook

2.5 Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 and the first quarter of 2014 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently very positive in indicating that growth prospects are also strong for the rest of 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction.

2.6 This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy has been that wage inflation has been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, recent falls in inflation have created the potential for the narrowing of this gap and it could narrow further during this year, especially if there is also a recovery in growth in labour productivity (leading to increases in pay rates).

2.7 With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

2.8 As for the Eurozone, concerns subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

Capita Interest Rate Forecasts

2.9 Capita Asset Services undertook a further review of its interest rate forecasts in late November, after the Bank of England's latest quarterly inflation report. However more recent developments to the Bank of England's forward guidance have necessitated a second updating in this quarter carried out on the 30th June. This latest forecast now includes a first increase in bank rate in quarter 1 of 2015 (previously quarter 4 of 2015).

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.40%	4.40%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%
50yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%

3. TREASURY MANAGEMENT STRATEGY STATEMENT

Annual Investment Strategy

3.1 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 24th February 2014. It outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity

3.2 The Authority will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep a significant proportion of investments short term to cover short term cash flow needs but also to seek out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions using the Capita suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Capita.

3.3 A full list of investments held as at 30 June 2014 are shown in Appendix A.

3.4 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.

3.5 The average level of funds available for investment purposes during the quarter was £33.743m (£28.477m in previous quarter). These 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.

Benchmark	Benchmark Return	Authority Performance	Investment interest to quarter 1
3 Month LIBID	0.41%	0.46%	£16,984

3.6 As illustrated, the authority outperformed the 3 month LIBID benchmark by 0.05 bp. It is also forecast that the Authority's budgeted investment target for 2014-2015 of £0.100m will be overachieved.

Borrowing Strategy

Prudential Indicators:

3.7 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.8 A full list of the approved limits (as amended) are included in the Financial Performance Report 2014-2015, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 2014 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

3.9 External borrowing as at 30 June 2014 was £26.214m (unchanged from previous quarter). All of this debt was at fixed rate with the remaining principal having an average rate/life of 4.231%/31.08 years.

Loan Rescheduling

3.10 No debt rescheduling was undertaken during the quarter.

Borrowing in Advance of Need

3.11 External borrowing of £26.214m as at 30 June 2014 exceeds the Capital Financing Requirement (CFR) figure of £23.430m, which reflects that borrowing of £2.784m has been taken out in advance of spending. This is as a result of capital slippage against the 2013-14 programme being more than forecast. It is forecast that capital spending in the next two years will increase the CFR sufficiently to reverse this over borrowing position. At this time this does not represent a breach of prudential indicators, as borrowing is permitted up to what is called the Authorised Limit i.e. £31.120m, and therefore no action is required.

New Borrowing

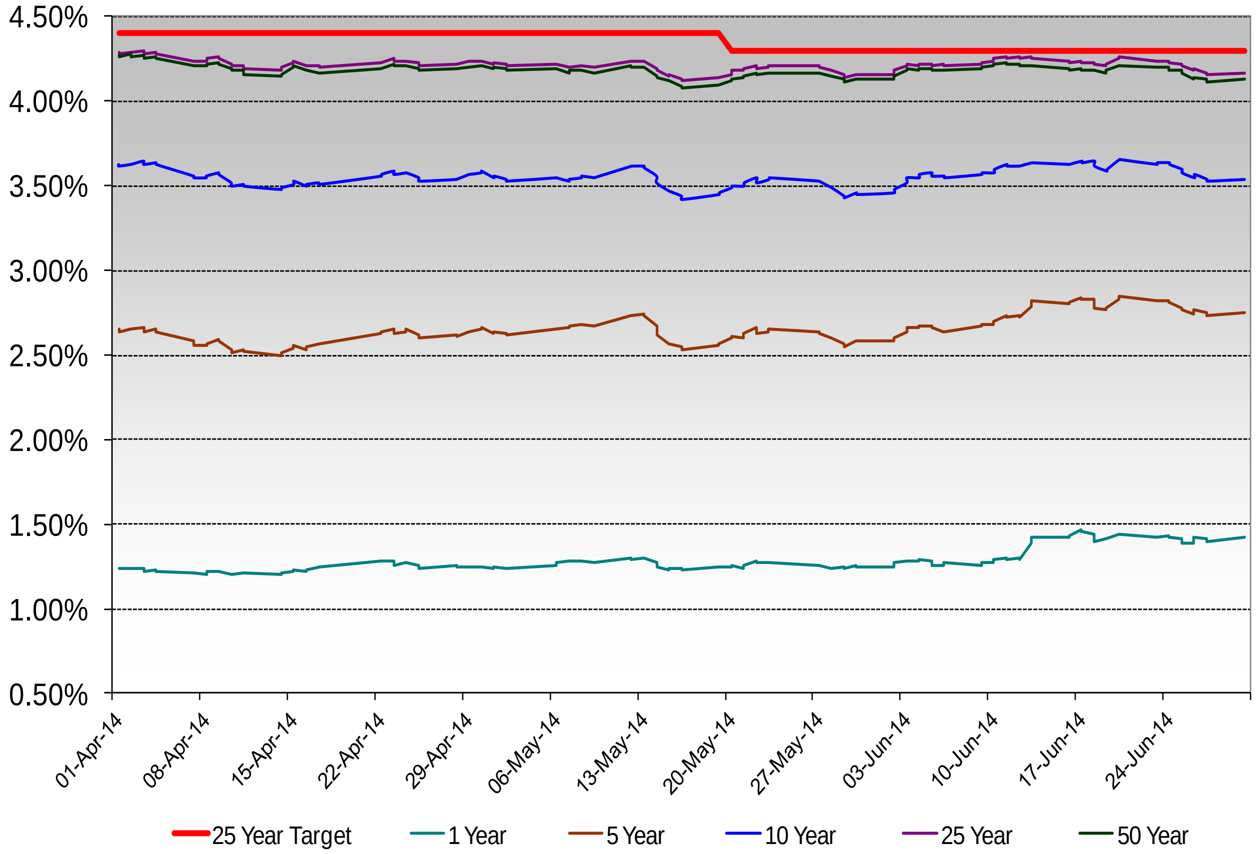
3.12 Capita's 25 year PWLB target rate for new long term borrowing for the quarter remained at 4.40% until May 19th when it fell to 4.30%. No new borrowing was undertaken during the quarter and none is planned during 2014-15. It is anticipated that use of internal borrowing and available grants will avoid the need to borrow from the PWLB in year; however this will be subject to certainty rates on offer and the delivery of the capital programme.

3.13 PWLB certainty rates for the quarter ended 30 June 2014 are shown below. DSFRA is eligible to borrow at certainty rates.

PWLB rates quarter ended 30.06.2014

	1 Year	**5 Year**	**10 Year**	**25 Year**	**50 Year**
Low	1.20%	2.50%	3.42%	4.12%	4.08%
Date	08/04/201	14/04/2	16/05/201	16/05/201	16/05/201
High	1.47%	2.85%	3.66%	4.30%	4.28%
Date	17/06/2014	20/06/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.29%	2.66%	3.56%	4.22%	4.18%

3.14 Borrowing rates for this quarter are shown overleaf.



4. SUMMARY

4.1 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides members with the first quarter report of the treasury management activities for 2014-2015 to June 2014. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken so far, with priority being given to liquidity and security over yield. Whilst investment returns are still low as a consequence of the fall in interest rates, the Authority is anticipating that investment returns will over achieve the budgeted target.

KEVIN WOODWARD
Treasurer

	Investments as at 30 June 2014				
Counterparty	Maximum to be invested	Total amount invested	Call or Term	Period invested	Interest rate(s)
	£m	£m			
Bank of Scotland	5.000	2.000	T	9 mths	0.83%
		1.500	T	1 yr	0.95%
		1.500	T	9 mths	0.80%
Barclays	10.000	2.000	T	3 mths	0.45%
		3.000	T	3 mths	0.45%
Goldman Sachs	5.000	5.000	T	6 mths	0.69%
Nationwide B/S	2.000	2.000	T	3 mths	0.48%
National Westminster Bank	5.000	5.000	T	3 mths	0.60%
Svenska Handelsbanken	5.000	5.000	C	Instant Access	Variable
Federated Prime Rate Money Market Funds	5.000	4.068	C	Instant Access	Variable
Total invested as at 30th June 2014		**31.068m**			