REPORT REFERENCE NO.	**RC/15/1**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**10 FEBRUARY 2015**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2014-2015 – QUARTER 3**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2014-2015 (to December) 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 IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 31 December 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 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 Gross Domestic Product (GDP) growth in 2013 at an annual rate of 2.7%, and 0.7% in Q1 2014, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards.

2.2 For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected.

2.3 The Monetary Policy Committee (MPC) is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage growth rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates.

2.4 Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

2.5 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November - Ethe lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

2.6 The US Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Federal rate will occur by the middle of 2015.

2.7 The Eurozone is facing an increasing threat from deflation. In November, the inflation rate fell to 0.3%. However, this is an average for all Eurozone countries and includes some countries with negative rates of inflation. Accordingly, the European Central Bank (ECB) did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

Capita Interest Rate Forecasts

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

	Mar-15	Jun-15	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%	1.25%	1.50%	1.75%	1.75%	2.00%
5yr PWLB rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

2.9 Capita Asset Services undertook a review of its interest rate forecasts on 5 January 2015 after a proliferation of fears in financial markets around the plunge in the price of oil had caused a flight from equities into bonds and from exposure to the debt and equities of emerging market oil producing countries to safe havens in western countries. These flows were compounded by further fears that Greece could be heading towards an exit from the Euro following the general election on January 25, and financial flows generated by the increasing likelihood that the ECB would soon be starting on full blown quantitative easing (QE) purchase of Eurozone government debt. In addition, there has been a sharp increase in confidence that the US will start increasing the Federal rate by the middle of 2015 due to the stunning surge in GDP growth in quarters 2 and 3 of 2014. This indicated that the US is now headed towards making a full recovery from the financial crisis of 2008.

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 31 December 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 £33.911m (£37.119m 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 3
3 Month LIBID	0.43%	0.45%	£63,050

3.6 As illustrated, the authority outperformed the 3 month LIBID benchmark by 0.02 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 December 2015 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

3.9 External borrowing as at 31 December 2014 was £26.059m (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 £26.059m as at 31 December 2014 exceeds the revised Capital Financing Requirement (CFR) figure of £22.582m, which reflects that borrowing of £3.362m has been taken out in advance of spending. This is as a result of slippage against the 2013-14 capital programme being more than forecast. At this time this does not represent a breach of prudential indicators, as borrowing is permitted to be above current CFR as long as future CFR estimates for current and next two financial years will utilise these loans. The Authority also maintains an Authorised Limit i.e. £31.120m and as loans fall below this, there is no immediate action required.

New Borrowing

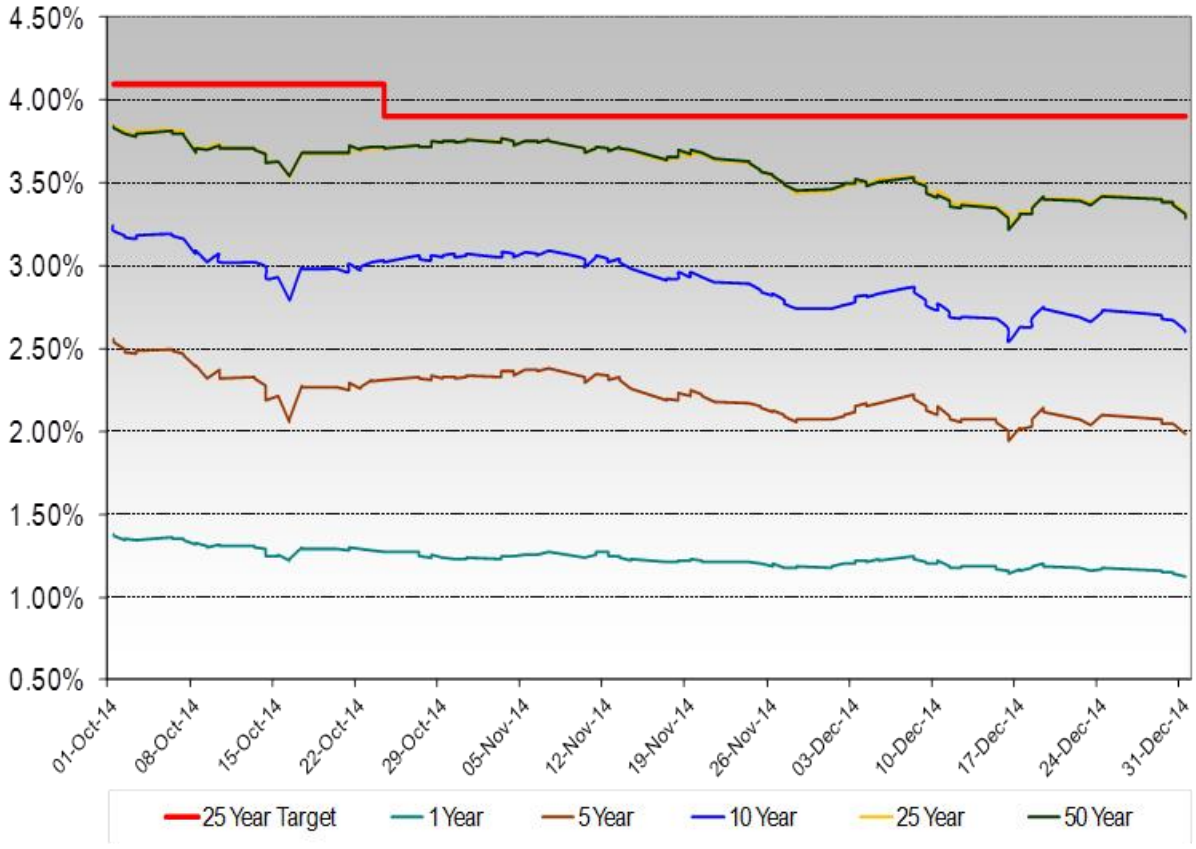
3.12 The 25 year PWLB target (certainty) rate for new long term borrowing fell from 4.10% to 3.90% in late October 2014. No new borrowing was undertaken during the quarter and none is planned during 2014-15. It is anticipated that use of internal borrowing and available grants will avoid the need to 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 31 December 2014 are shown overleaf. DSFRA is eligible to borrow at certainty rates.

PWLB rates quarter ended 31.12.2014

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.12%	1.94%	2.54%	3.24%	3.22%
Date	31/12/2014	16/12/2014	16/12/2014	16/12/2014	16/12/2014
High	1.38%	2.56%	3.24%	3.85%	3.84%
Date	01/10/2014	01/10/2014	01/10/2014	01/10/2014	01/10/2014
Average	1.24%	2.23%	2.91%	3.60%	3.60%

3.14 Borrowing rates for this quarter are shown below.



4. SUMMARY

4.1 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides members with the third quarter report of the treasury management activities for 2014-2015 to December 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.

4.2 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 31 December 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	6 mths	0.70%
		1.500	T	1 yr	0.95%
		1.500	T	6 mths	0.70%
Barclays	10.000	2.000	T	6 mths	0.45%
		3.000	T	6 mths	0.61%
		2.000	T	6 mths	0.60%
Goldman Sachs	5.000	5.000	T	3 mths	0.45%
Nationwide B/S	2.000	2.000	T	6 mths	0.63%
National Westminster Bank	5.000	5.000	T	3 mths	0.40%
Svenska Handelsbanken	5.000	0.010	C	Instant Access	Variable
Ignis Sterling Liquidity Money Market Fund	5.000	5.000	C	Instant Access	Variable
Black Rock Money Market Fund	5.000	0.639	C	Instant Access	Variable
Total invested as at 31 December 2014		**29.649m**			