REPORT REFERENCE NO.	**RC/15/7**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**2 SEPTEMBER 2015**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2015-2016 – QUARTER 1**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2015-2016 (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 IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 30 June 2015.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/15/3 – as approved at the meeting of the DSFRA meeting held on the 20 February 2015.

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 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 in 2013 at an annual rate of 2.7% and 3.0% in 2014, quarter 1 of 2015 was disappointing at only 0.4%, though subsequent data indicates that this could well be revised up further down the line and also indicates a return to stronger growth in quarter 2. In its May quarterly Inflation Report, the Bank of England reduced its GDP forecast for 2015 from 2.9% to 2.5% and from 2.9% to 2.7% in 2016, while increasing its forecast for 2017 from 2.4% to 2.7%.

2.2 Uncertainty around the likely result of the UK general election in May has obviously now evaporated although this has been replaced by some uncertainty around the potential impact on the UK economy of the EU referendum promised by, or in, 2017. In addition, the firm commitment of the Conservative Government to eliminating the deficit within the term of this Parliament will have an impact on GDP growth rates. However, the MPC is fully alert to this and will take that into account, and also the potential spill over effects from the Greek crisis, in making its decisions on the timing of raising Bank Rate.

2.3 As for the American economy, confidence has improved markedly in this quarter that the US will start increasing the Fed funds rate by the end of 2015 due to a return to strong economic GDP growth after a disappointing start to the year in quarter 1, (a contraction of 0.2%), after achieving 2.4% growth in 2014.

2.4 In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth, though it remains to be seen whether this will have an enduring effect as strong as the recovery in the US and UK.

Interest Rate Forecasts

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

	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%	1.50%	1.50%	1.75%
5yr PWLB rate	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%
50yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%

2.6 Capita Asset Services undertook a review of its interest rate forecasts after the May Bank of England Inflation Report. The ECB's quantitative easing programme to buy up EZ debt caused an initial widespread rise in bond prices and, correspondingly, a fall in bond yields to phenomenally low levels, including the debt of some European countries plunging into negative yields. Since then, fears about recession in the EZ, and around the risks of deflation, have abated and so there has been an unwinding of this initial phase with bond yields rising back to more normal, though still historically low yields.

2.7 This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 1 of 2016 to quarter 2 of 2016 as a result primarily of poor growth in quarter 1, weak wage inflation and the recent sharp fall in inflation due to the fall in the price of oil and the impact of that on core inflation. The UK fell marginally into deflation in April (-0.1%) and figures near zero will prevail for about the next six months until the major fall in oil prices in the latter part of 2014 falls out of the twelve month calculation of CPI inflation. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation, though some consumers will not have seen that benefit come through for them.

3. **<u>TREASURY MANAGEMENT STRATEGY STATEMENT</u>**

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 20th February 2015. 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 2015 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 £33.566m (£31.469m 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	0.44%	0.52%	£29,096

3.6 As illustrated, the authority outperformed the 3 month LIBID benchmark by 0.08bp. It is also forecast that the Authority's budgeted investment target for 2015-2016 of £0.116m will be overachieved.

<u>Borrowing Strategy</u>

<u>Prudential Indicators</u>:

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 2015-2016, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 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 30 June 2015 was £25.943m (unchanged from previous quarter), and forecast to reduce to £25.817m as at 31 March 2016. All of this debt was at fixed rate with the remaining principal having an average rate/life of 4.231%/30.09 years.

Loan Rescheduling

3.10 No debt rescheduling was undertaken during the quarter.

Borrowing in Advance of Need

3.11 The external borrowing position at the end of the previous financial year of £25.943m exceeded the Capital Financing Requirement (CFR) of £22.582m, which reflects that borrowing of £3.361m had been taken out in advance of spending. This was as a result of slippage against the 2013-14 capital programme being more than forecast. As was reported to the Authority at its meeting in May 2015, in considering the final Treasury Management Performance Report for 2014-15, 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.

3.12 For the current financial year it is forecast that by 31 March 2016 external borrowing will be £25.817m, which will match the CFR figure as at the same date. This will mean that there will be no over-borrowing position by the end of the current financial year. .

New Borrowing

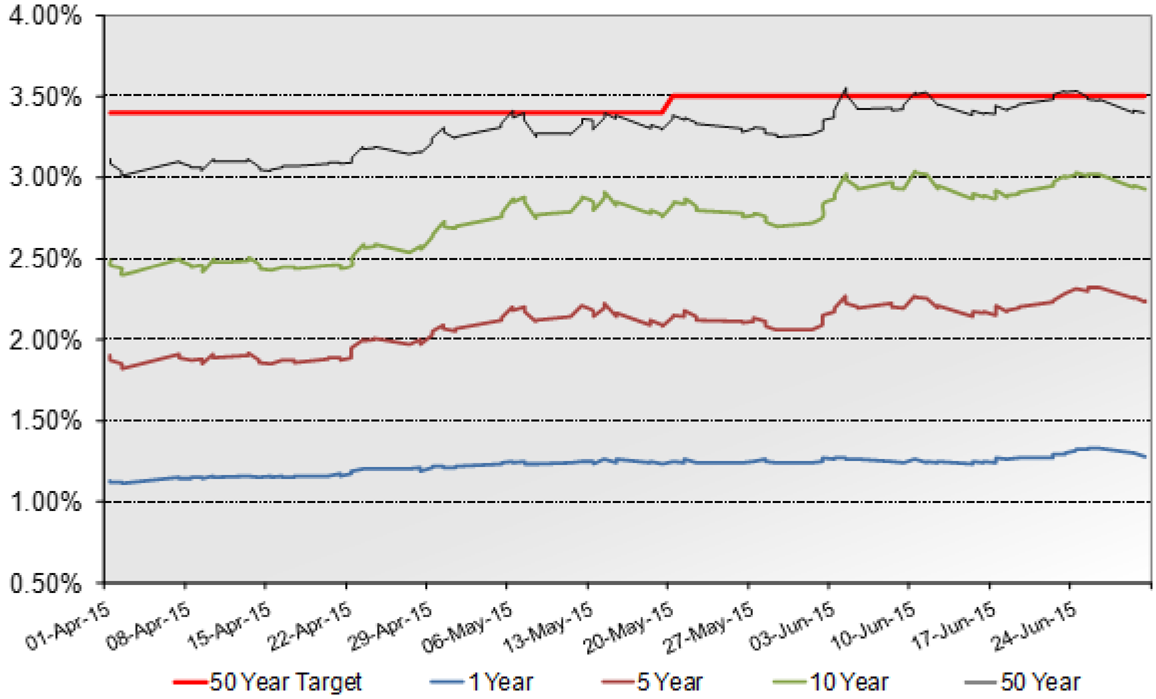
3.13 The 25 year PWLB target (certainty) rate for new long term borrowing, for the quarter ending 30th June, rose slightly from 3.40% to 3.50% after the May Bank of England Inflation report. No new borrowing was undertaken during the quarter and none is planned during 2015-16. It is anticipated that use of internal borrowing 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.

3.14 PWLB certainty rates for the quarter ended 30 June 2015 are shown below. DSFRA is eligible to borrow at certainty rates.

PWLB rates quarter ended 30 June 2015

3.15 Borrowing rates for this quarter are shown below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/2015	02/04/2015	02/04/2015	02/04/2015	02/04/2015
High	1.33%	2.32%	3.04%	3.65%	3.55%
Date	25/06/2015	25/06/2015	10/06/2015	24/06/2015	04/06/2015
Average	1.23%	2.09%	2.75%	3.37%	3.29%



4. **<u>SUMMARY</u>**

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 2015-2016 to June 2015. 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 2015					
Counterparty	Maximum to be invested	Total amount invested	Call or Term	Period invested	Interest rate(s)
	£m	£m			
Bank of Scotland	5.000	2.100	T	1 yr	1.000%
		1.400	T	1 yr	1.000%
		1.500	T	6 mths	0.700%
Goldman Sachs	5.000	5.000	T	3 mths	0.530%
Barclays	8.000	3.000	T	6 mths	0.610%
		2.500	T	6 mths	0.600%
Santander	5.000	1.000	T	6 mths	0.750%
		1.500	T	3 mths	0.550%
		2.000	T	6 mths	0.690%
Leeds Building Society	2.000	2.000	T	3 mths	0.420%
Nationwide Building Society	2.000	2.000	T	6 mths	0.660%
Yorkshire Building Society	2.000	2.000	T	3 mths	0.470%
Ignis Sterling Liquidity Money Market Fund	5.000	4.743	C	Instant Access	Variable
Total invested as at 30 June 2015		30.743m			