REPORT REFERENCE NO.	**RC/15/10**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**19 NOVEMBER 2015**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2015-2016 – QUARTER 2**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2015-2016 (to September) 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 September 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 Fire & Rescue Authority has 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 UK Gross Domestic Product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly being equal to that of the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y).

2.2 Growth is expected to weaken marginally to about +0.5% in quarter 3 as the economy faces headwinds for exporters from the appreciation of Sterling against the Euro and weak growth in the European Union (EU), China and emerging markets, plus the dampening effect of the Government's continuing austerity programme, although the pace of reductions was eased in the May Budget. However, the Purchasing Manager's Index, (PMI), for services issued on 5 October would indicate an even lower growth rate of around +0.3%, in quarter 4, which would be the lowest growth rate since the end of 2012.

2.3 Despite these headwinds, the Bank of England August Inflation Report had included a forecast for growth to remain around 2.4 – 2.8% over the next three years. This is driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that Consumer Prices Index (CPI) inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth. Since then, worldwide economic statistics have been distinctly weak so it would not be a surprise if the next Inflation Report in November were to cut those forecasts.

2.4 The August Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon re-join the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.

2.5 There are therefore considerable risks around whether inflation will rise in the near future as strongly as previously expected. This will make it more difficult for the central banks of both the US and the UK to raise rates as soon as had been expected, especially given the recent major concerns around the slowdown in Chinese growth. The knock on impact on the earnings of emerging countries from falling oil and commodity prices and the volatility seen in equity and bond markets in 2015 so far could potentially spill over to impact the real economies rather than just financial markets.

2.6 The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015. Whilst there had been confident expectations during the summer that the Federal Reserve could start increasing rates at its meeting on 17 September, or if not by the end of 2015, the recent downbeat news about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Federal Reserve's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were disappointingly weak and confirmed concerns that US growth is likely to weaken.

2.7 This has pushed back expectations of a first rate increase from 2015 to 2016. However, there are increasing concerns, both in the US and UK, that the growth rates currently being achieved are only being achieved with monetary policy being highly aggressive with central rates at near zero and huge Quantitative Easing (QE) in place. This is causing an increasing debate as to how realistic it will be for central banks to start on reversing such aggressive monetary policy. This may be deferred, therefore, until such time as strong growth rates are more firmly established and confidence increases that inflation is going to get back to around 2% within a 2-3 year time horizon.

2.8 In the Eurozone (EZ), the European Commission Bank (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.

2.9 GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Interest Rate Forecasts

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

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

2.11 Capita Asset Services undertook a review of its interest rate forecasts on 11 August after the August Bank of England Inflation Report. This latest forecast includes no change in the timing of the first increase in Bank Rate as being quarter 2 of 2016. With CPI inflation now likely to be at or near zero for most of 2015, it is difficult for the Monetary Policy Committee (MPC) to make a start on increasing Bank Rate when the Inflation Report forecast was also notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon.

2.12 Despite average weekly earnings ticking up to 2.9% y/y in the three months ending in July, (as announced in mid-September), this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate soon as labour productivity growth meant that net labour unit costs are still only rising by about 1% y/y. The significant appreciation of Sterling against the Euro in 2015 has also acted as a dampening to UK growth while sharp volatility in financial markets since the Inflation Report has depressed equity prices, raised bond prices and lowered bond yields (and PWLB rates).

2.13 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. 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 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 September 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.

3.5 The average level of funds available for investment purposes during the quarter was £34.399m (£33.566m 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 2
3 Month LIBID	0.43%	0.56%	£49,949

3.6 As illustrated, the authority outperformed the 3 month LIBID benchmark by 0.13bp. It is also forecast that the Authority's budgeted investment target for 2015-2016 of £0.116m 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 2015-2016, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 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 September 2015 was £25.880m (£25.944m in previous quarter), and forecast to reduce to £25.817m as at 31 March 2016 as a result of debt repayments. 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. The Authority has carried out some options appraisal work to determine if it there are opportunities to repay existing loans but the current PWLB early repayment rates mean there is no benefit in undertaking premature loan repayment. It will be kept under review and further updates will be provided in the quarterly Treasury Management reports.

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 and 2014-15 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

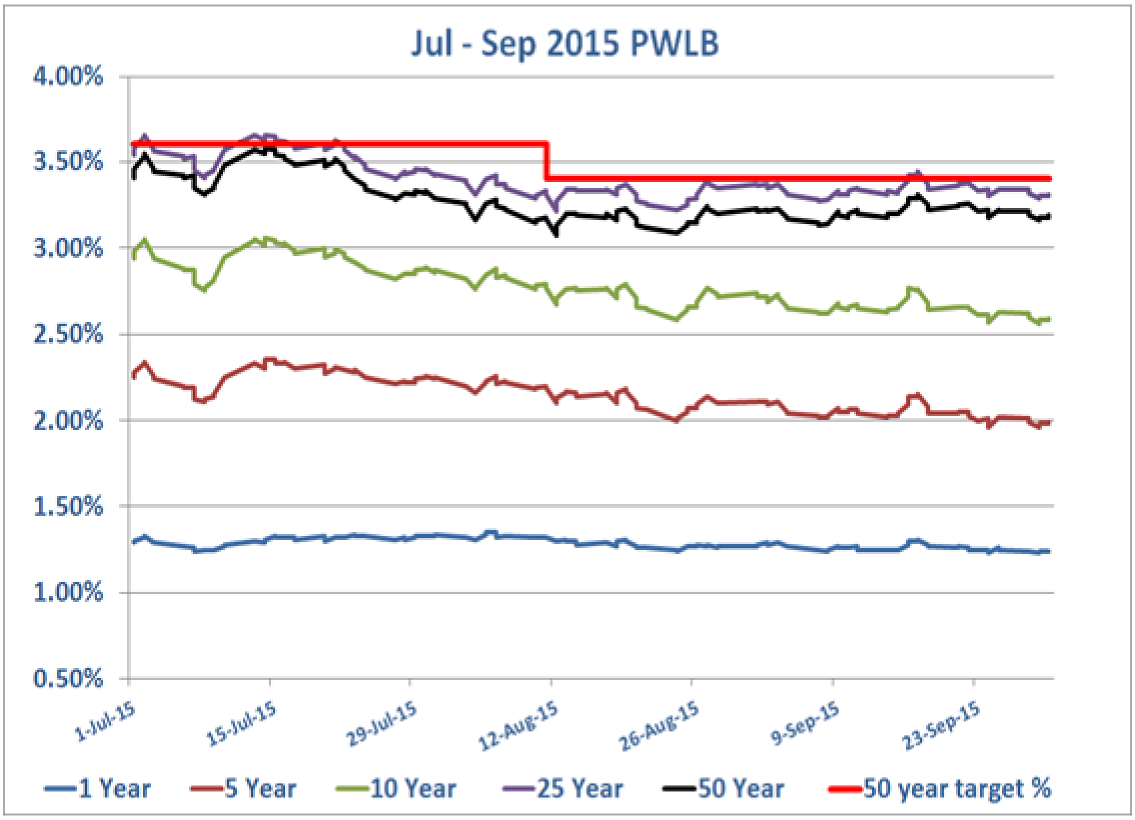
3.13 As outlined below, the general trend in Public Works Loan Board (PWLB) rates has been an increase in interest rates during the first quarter but then a fall during the second quarter. The 50 year PWLB target (certainty) rate for new long term borrowing, for the quarter ending 30th September, fell slightly from 3.60% to 3.40% after the August 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 September 2015 are shown overleaf. DSFRA is eligible to borrow at certainty rates.

PWLB rates quarter ended 30 September 2015

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.23%	1.96%	2.56%	3.21%	3.07%
Date	24/09/2015	24/09/2015	29/09/2015	12/08/2015	12/08/2015
High	1.35%	2.35%	3.06%	3.66%	3.58%
Date	05/08/2015	14/07/2015	14/07/2015	02/07/2015	14/07/2015
Average	1.29%	2.15%	2.78%	3.40%	3.28%

3.15 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 first quarter report of the treasury management activities for 2015-2016 to September 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 September 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	4.000	T	3 mths	0.540%
Barclays	8.000	2.500	T	6 mths	0.690%
		3.300	T	6 mths	0.660%
		2.000	T	6 mths	0.700%
Santander	5.000	1.000	T	6 mths	0.750%
		2.000	T	3 mths	0.700%
		2.000	T	6 mths	0.690%
Coventry Building Society	2.000	2.000	T	6 mths	0.600%
Nationwide Building Society	2.000	2.000	T	6 mths	0.660%
Yorkshire Building Society	2.000	2.000	T	3 mths	0.470%
Black Rock Money Market Fund	5.000	1.725	C	Instant Access	Variable
Ignis Sterling Liquidity Money Market Fund	5.000	4.841	C	Instant Access	Variable
Total invested as at 30 September 2015		**30.366m**			