REPORT REFERENCE NO.	**RC/17/1**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**8 FEBRUARY 2017**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2016-2017 – QUARTER 3**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2016-17 (to December 2016) 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	A – Investments held as at 31 December 2016.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/16/3 – as approved at the meeting of the DSFRA meeting held on the 19 February 2016.

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) Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The Code recommends that Members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Authority is implementing best practice in accordance with the Code and 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

2.1 UK Growth Domestic Product (GDP) has been quite strong since 2013 with annual growth rate above 2% in all years other than 2015 when it fell to 1.8%. As a result, the UK has one of the leading rates among the G7 countries. Economic growth has been fairly robust at +0.6% quarter on quarter, +2.2% year on year in quarter 3 of 2016 to confound the pessimistic forecasts by the Bank of England in August 2016 and by other forecasters, which expected to see near zero growth during 2016 after the referendum. Prior to the referendum, the UK economy had been facing headwinds for exporters from the appreciation of sterling against the Euro plus weak growth in the European Union (EU), China and emerging markets, and the dampening effect of the Government's continuing austerity programme.

2.2 The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, there was then a sharp recovery in confidence and business surveys and the fall in the value of sterling has had a positive effect in boosting manufacturing in the UK due to improved competitiveness in world markets.

2.3 The Bank of England meeting on 4 August 2016 addressed its forecast of a slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report cut the forecast for growth in 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. Whilst the Monetary Policy Committee (MPC) was prepared to cut the Bank Rate again by the end of 2016, Carney also warned that the Bank could not do all the heavy lifting and suggested that the Government would need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor, Phillip Hammond, announced after the referendum result, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November 2016 and which he duly delivered.

2.4 The robust growth in quarter 3 of +0.6%, plus forward indicating business surveys also being very positive on growth, caused the MPC in November to pull back from another cut in Bank Rate. The November Inflation Report also included a forecast for inflation to rise to around 2.7% in 2018 and 2019, well above its 2% target, due to a sharp rise in the cost of imports as a result of the sharp fall in the value of sterling after the referendum. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

2.5 The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Growth in quarter 1 of 2016 of +0.8% on an annualised basis, and quarter 2 at +1.4%, was disappointing. However, quarter 3 came in very strongly at +3.5% and forward indicators are pointing towards robust growth in 2017, especially if Trump’s expansionary plans are put into effect.

2.6 The Federal Bank (Fed) embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, caused a delay in the timing of the second increase of +0.25% until this December’s meeting. Three or four further increases are now expected in both 2017 and 2018.

2.7 In the Eurozone, the European Central Bank (ECB) commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected Eurozone countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December 2015 and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March 2006 meeting, it also increased its monthly asset purchases to €80bn. In December 2016, it extended its QE programme; monthly purchases at €80bn will continue to March 2017 and then continue at €60bn until December 2017.

2.8 These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 3 2016 (1.7% year on year) but forward surveys are, at last, positive about a modest upturn to growth while inflation has also started to increase significantly. There have been many comments from forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

2.9 Japan has struggled for many years to boost anaemic growth despite massive fiscal and monetary stimulus, but quarter 3 came in at +2.7% year on year. Chinese economic growth has been weakening and medium term risks have been increasing.

Interest Rate Forecasts

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

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

2.11 The MPC, cut Bank Rate from 0.50% to 0.25% on 4 August 2016 in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half of 2016 than that forecast. Also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling after early August. Consequently, the Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth.

2.12 During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will retain a loose monetary policy to deal with the weaker growth outlook and is expected to keep bank rate on hold at 0.25% until June 2019 with gradual increases to end at 0.75% in March 2020. This approach will support growth prospects, which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. However, if strong domestically generated inflation (e.g. from wage increases within the UK) were to emerge, then the pace and timing of increases in Bank Rate could be brought forward. Based on the current forecast, the cost of medium to long term borrowing is expected to rise from current levels as UK inflation increases to around 3% over the next couple of years.

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 19 February 2016. It outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

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. The highly credit rated financial institutions will be 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 2016 are shown in Appendix A of this report.

3.4 The average level of funds available for investment purposes during the quarter was £38.800m (£37.998m 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	0.26%	0.54%	£78,769.

3.5 As illustrated, the Authority outperformed the 3 month LIBID benchmark by 0.28bp. Whilst investment future returns will inevitably be adversely impacted by the reduction in the bank base rate to 0.25% during Q2, it is currently forecast that the actual investment return for 2016-17 will exceed the Authority's budgeted investment target of £0.154m.

BORROWING STRATEGY

Prudential Indicators:

3.6 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.

3.7 A full list of the approved limits (as amended) are included in the Financial Performance Report 2016-2017, considered elsewhere on the agenda for this meeting, which confirms that no breaches of the Prudential Indicators were made in the period to December 2016 and that there are no concerns that they will be breached during the financial year.

Current external borrowing

3.8 External borrowing as at 31 December 2016 was £25.770m, a small reduction from the figure of £25.790m as at 30 September 2016. All of this debt was at fixed rate with the remaining principal having an average rate/life of 4.233%/28.45 years.

Loan Rescheduling

3.9 No debt rescheduling was undertaken during the quarter. The Authority will continue to work closely with our treasury advisors to explore any opportunities to repay existing loans, however current Public Works Loan Board (PWLB) early repayment rates mean there is no financial benefit in undertaking premature loan repayment at this time.

New Borrowing

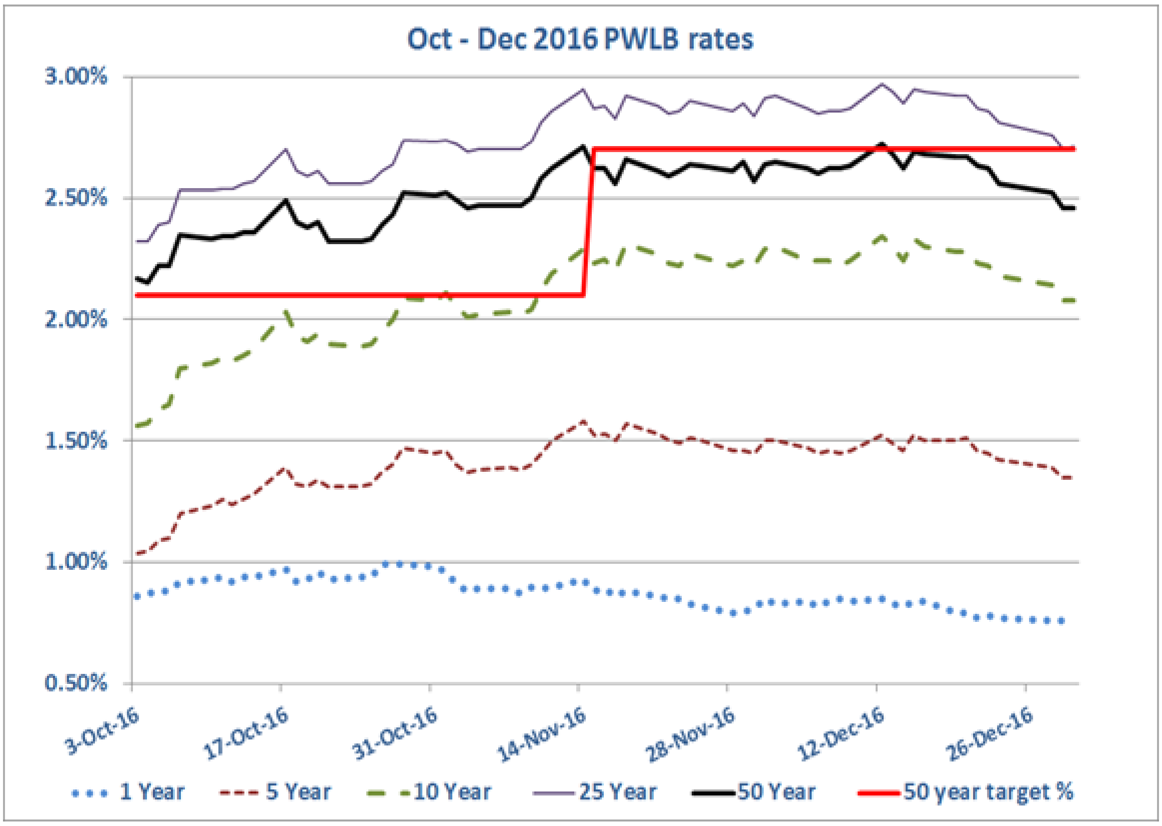
3.10 As depicted in the graph(s) below there has been some volatility in PWLB rates during the quarter. The 50 year PWLB target (certainty) rate for new long term borrowing started at 2.10% and ended at 2.70%.

3.11 No new borrowing was undertaken during the quarter and none is planned during 2016-17. It is anticipated that use of internal borrowing will avoid the need to borrow from the PWLB in year.

PWLB rates quarter ended 31 December 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.76%	1.04%	1.56%	2.32%	2.15%
Date	28/12/2016	03/10/2016	03/10/2016	03/10/2016	04/10/2016
High	0.99%	1.58%	2.34%	2.97%	2.72%
Date	26/10/2016	14/11/2016	12/12/2016	12/12/2016	12/12/2016
Average	0.88%	1.40%	2.09%	2.74%	2.51%

3.12 Borrowing rates for this quarter are shown below.



Borrowing in Advance of Need

3.13 The Authority has not borrowed in advance of need during this quarter.

4. SUMMARY AND RECOMMENDATION

4.1 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides members with the second quarter report of the treasury management activities for 2016-2017 to December 2016. 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 still anticipating that investment returns will meet the budgeted target.

KEVIN WOODWARD
Treasurer

APPENDIX A TO REPORT RC/17/1

Investments as at 31 December 2016					
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	1.050%
		1.400	T	6 mths	0.650%
		1.500	T	6 mths	0.650%
Qatar National Bank	5.000	1.000	T	1 yr	1.000%
		3.000	T	1 yr	0.820%
		1.000	T	1 yr	0.750%
Santander UK PLC	5.000	1.000	T	6 mths	0.510%
		2.000	T	6 mths	0.460%
		2.000	T	6 mths	0.460%
Leeds Building Society	2.000	1.000	T	6 mths	0.430%
Coventry Building Society	2.000	2.000	T	6 mths	0.370%
Nationwide Building Society	2.000	2.000	T	6 mths	0.400%
Goldman Sachs	5.000	5.000	T	6 mths	0.595%
Sumitomo Mitsui	5.000	3.200	T	6 mths	0.420%
		1.800	T	6 mths	0.460%
Svenska Handelsbanken	5.000	2.000	C	Instant Access	Variable
Federated Liquidity Fund	5.000	0.330	C	Instant Access	Variable
Black Rock Money Market Fund	5.000	0.987	C	Instant Access	Variable
Ignis Sterling Liquidity Money Market Fund	6.000	2.749	C	Instant Access	Variable
Total invested as at 31 December 2016		**£36.066M**			