REPORT REFERENCE NO.	**RC/16/13**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**16 NOVEMBER 2016**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2016-2017 – QUARTER 2**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2016-17 (to September 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	Appendix A – Investments held as at 30 September 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 FRA 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) growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme.

2.2 The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

2.3 The Bank of England meeting on August 4th 2016 addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The August Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 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. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Philip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23 2016.

2.4 The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. The Consumer Price Index (CPI) has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year. In addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years.

2.5 The Monetary Policy Committee (MPC), however, is expected to look through 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.

2.6 The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Federal Reserve 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, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

2.7 In the Eurozone, the European Central Bank commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ 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 and March 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 meeting, it also increased its monthly asset purchases to €80bn.

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 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many 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 is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while 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:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

2.11 Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% by the end of December and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

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 19th 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 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 2016 are shown in Appendix A.

3.4 The average level of funds available for investment purposes during the quarter was £37.998m (£29.533m 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	0.308%	0.46%	£60,696.

3.5 As illustrated, the Authority outperformed the 3 month LIBID benchmark by 0.152bp. 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 Authority's budgeted investment target for 2016-2017 of £0.154m will still be achieved.

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, which confirms that no breaches of the Prudential Indicators were made in the period to September 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 30 September 2016 was £25.790m, a small reduction from the figure of £25.817m as at 30 June 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

3.9 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

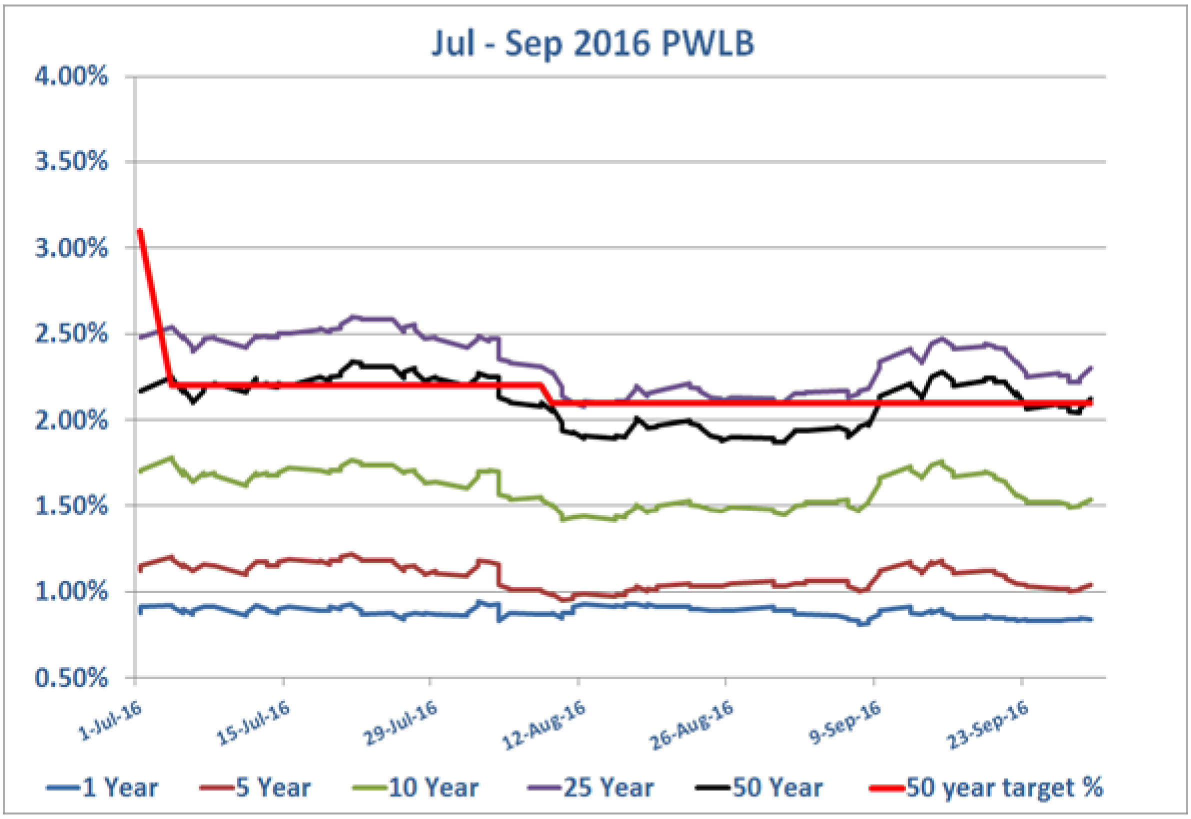
3.10 As depicted in the graph(s) below there has been some volatility in PWLB rates during the quarter. The 50 year PWLB target (certainty) rate for new long term borrowing started at 3% and ended at 2.10%.

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 30 September 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.81%	0.95%	1.42%	2.08%	1.87%
Date	07/09/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	0.94%	1.22%	1.78%	2.60%	2.34%
Date	02/08/2016	21/07/2016	04/07/2016	21/07/2016	21/07/2016
Average	0.88%	1.09%	1.60%	2.34%	2.11%

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 September 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/16/13

Investments as at 30 September 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	3 mths	0.650%
		1.500	T	1 yr	1.020%
Qatar National Bank	2.000	1.000	T	1 yr	1.000%
		1.000	T	1 yr	0.750%
Santander UK PLC	5.000	1.000	T	6 mths	0.660%
		2.000	T	6 mths	0.460%
		2.000	T	6 mths	0.460%
Leeds Building Society	2.000	1.000	T	6 mths	0.670%
Coventry Building Society	2.000	2.000	T	6 mths	0.600%
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%
Svenska Handlesbanken	5.000	5.000	C	Instant Access	Variable
Federated Liquidity Fund	5.000	1.600	C	Instant Access	Variable
Black Rock Money Market Fund	5.000	4.660	C	Instant Access	Variable
Ignis Sterling Liquidity Money Market Fund	6.000	4.316	C	Instant Access	Variable
Total invested as at 30 September 2016		**£40.776M**			