REVENUE AND CAPITAL BUDGET MONITORING REPORT - TO END OF SEPTEMBER 2016

Treasury Management Update

Quarter 2 (July-September), 2016-17

Purpose:

The Chartered Institute of Public Finance and Accountancy (CIPFA) issued the revised Code of Practice for Treasury Management in November 2009; it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this Council is implementing best practice in accordance with the Code.

Economic climate:

In summary, the third quarter of 2016 (calendar year) saw:

- UK voted to leave the EU, triggering widespread market turmoil before global financial market sentiment rebounded;
- Global GDP concerns remain, particularly given the continued slowdown in the Chinese economy, the US presidential elections and the aftermath of the UK EU referendum vote result;
- The Bank of England Monetary Policy Committee (MPC) reduced base rate to 0.25%, increased asset purchases (Quantitative Easing) to £435bn and purchased £10bn of corporate bonds.
- Fall in sterling likely to push up inflation in the near term, hastening its return to the 2% target and possibly causing it to rise above target before effect dissipates;
- Unemployment levels fell to 4.9% although expected to rise over the course of the next year;

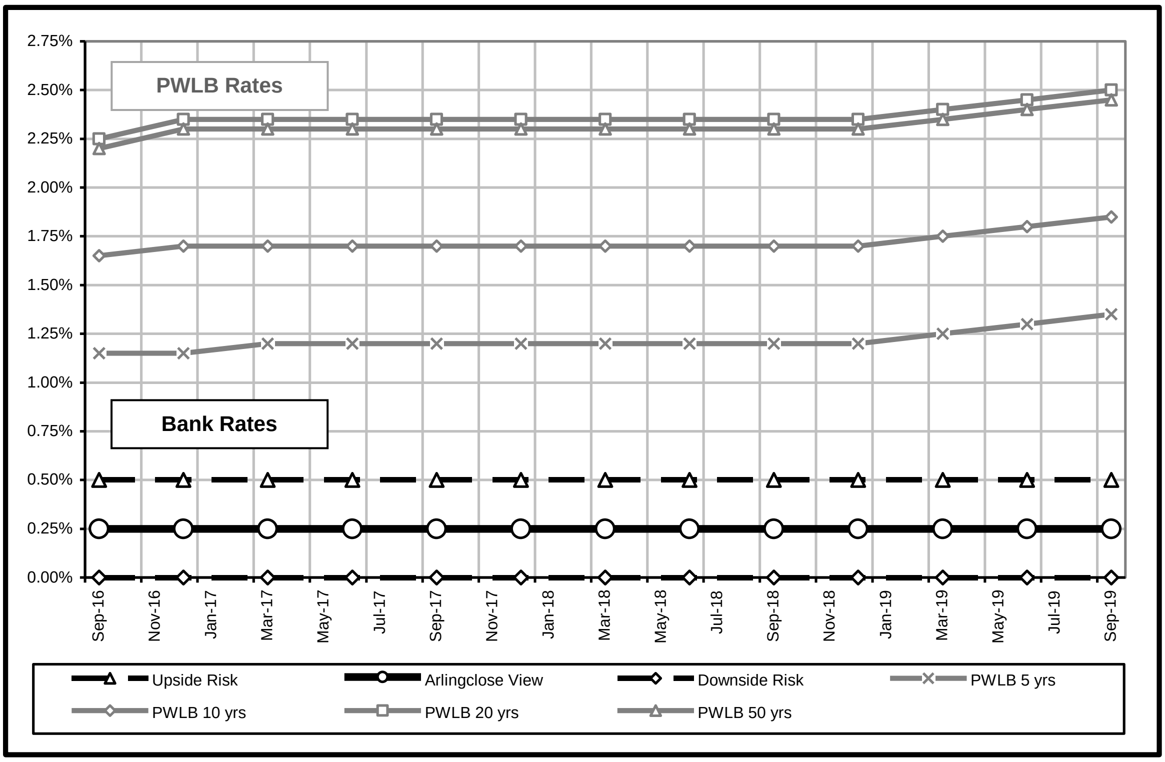
Interest rate forecast:

The latest forecast for interest rates of treasury advisors Arlingclose over the next three years is set out below, along with a sensitivity analysis of potential upside and downside risk to official bank rate.

Table 1: Interest Rate Forecast

	Sept 2016	Dec 2016	Mar 2017	Jun 2017	Sept 2017	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018	Mar 2019	Jun 2019	Sept 2019
Official Bank Rate													
Upside Risk	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Arlingclose View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Downside Risk	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%
Public Works Loans Board Implied Rates (Certainty Rate)													
5 years	1.15%	1.15%	1.20%	1.20%	1.20%	1.20%	1.20%	1.20%	1.20%	1.20%	1.25%	1.30%	1.35%
10 years	1.65%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.75%	1.80%	1.85%
20 years	2.25%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.40%	2.45%	2.50%
50 years	2.20%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.35%	2.40%	2.45%

Chart 1: Interest Rate Forecast



There are many risks to the forecast set out above, principally around the uncertain outlook for the UK economy, and a listing of key underlying assumptions is attached at Appendix A. Budget estimates prudently include sensitivity analysis of the impact that a slower than forecast economic recovery would have upon the Council.

Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 17th February 2016. It sets out the Council's investment priorities as being:

1. **S**ecurity of Capital;
2. **L**iquidity; and
3. **Y**ield

The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

The table below summarises the forecast investment maturity position at 30th September 2016.

Table 2: Forecast Investment Maturity Position at 30th September 2016

Period	Product type / Maturity	Amount	
		£	**%**
Instant Access	Banks	£2,384	0.0
	Money Market Funds	£65,925,000	23.5
		£65,927,384	**23.5**
Fixed Term – Building Societies	3-6 months to maturity	**£1,000,000**	**0.4**
Fixed Term - Local Authorities	0-3 months to maturity	£22,000,000	7.8
	3-6 months to maturity	£20,000,000	7.1
	9-12 months to maturity	£2,000,000	0.7
	>12 months to maturity	£18,500,000	6.6
		£62,500,000	**22.2**
Certificates of Deposit – Banks	0-3 months to maturity	£47,800,000	17.0
	3-6 months to maturity	£57,000,000	20.3
	6-9 months to maturity	£18,000,000	6.4
		£122,800,000	**43.7**
Covered Bonds – Fixed Rate	1-2 years to maturity	**£5,357,357**	**1.9**
Covered Bonds – Floating Rate	1-2 years to maturity	£5,005,280	1.8
	2-3 years to maturity	£4,000,000	1.4
		£9,005,280	**3.2**
Property Fund	4-5 years to maturity*	**£14,267,765**	**5.1**
Total Investment Portfolio		**£280,857,786**	**100.0**

* In order to recoup initial BID/OFFER pricing spread. Monthly valuation dates for purchase/sale of units - redemptions may be delayed should the fund be required to raise cash to meet this commitment.

Investment rates available in the market continue to be low for short-term durations, with some pickup in value in longer durations. Investment balances at the 31st March 2016 were £262.373m. Due to the front-loaded nature of various government funding streams the average level of funds available for investment purposes during this quarter is forecast at £290.962m.

Balances are forecast to fall to circa £150.0m by 31st March 2017 as internal resources are applied to fund capital expenditure demands in lieu of further borrowing, effectively reducing the cost of carrying debt at higher cost than income generated through investment of balances. A significant capital project payment of circa £130m for the Residual Waste Treatment Facility was expected to occur September 2016, however the project completion has been delayed. If this payment is delayed beyond March 2017, balances held at year-end will be higher.

Table 3: Forecast Benchmark Performance – Q2

Benchmark	Benchmark Return	Council Performance
3 month LIBID	0.38%	0.76%

As illustrated, the authority outperformed the benchmark by 38 basis points. Market rates have dropped significantly in the wake of the Brexit vote; however the Council's pre-existing medium and long term investment returns have provided some protection from immediate volatility. Latest projections for the financial year are reported through the Budget Monitoring process.

New Borrowing

No new borrowing for capital purposes was undertaken during the quarter.

Below is a table setting out the profile of existing borrowing as at 30th September 2016.

Table 4: Borrowing Profile as at 30th September 2016

	Borrowing	
	£m	**%**
Under 12 months	2.520	0.5
1-2 years	4.025	0.8
2-5 years	28.490	5.8
5-10 years	63.650	12.9
Over 10 years	393.244	80.0
	491.929	**100.0**

Debt Restructuring

Debt rescheduling opportunities have been limited due to the current economic climate and consequent structure of interest rates following increases in PWLB new borrowing rates in October 2010. Officers continue to monitor the position regularly.

No debt rescheduling was undertaken during the quarter.

However Barclay Bank, provider of one of the Council's Lender Option Borrower Option (LOBO) loans, has its waived rights to any future rate increases by Deed Poll. The loan outstanding therefore reverts to being classified as a fixed term, fixed rate loan.

Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were approved alongside the TMSS on 17th February 2016.

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement.

The Prudential and Treasury Indicators are shown in Appendix B.

Appendix A
Interest Rate Forecast Commentary; Arlingclose

Underlying assumptions to interest rate forecast

- The economic trajectory for the UK has been immeasurably altered following the vote to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The short to medium-term outlook is somewhat more downbeat due to the uncertainty generated by the result and the forthcoming negotiations (notwithstanding the Olympic and summer feel-good effects). The rapid installation of a new prime minister and cabinet lessened the political uncertainty, and the government/Bank of England have been proactive in tackling the economic uncertainty.
- PMI data, and consumer and business confidence surveys published for July showed a significant downturn in business activity. An overreaction was always expected due to the unexpected result and confidence indicators, particularly consumer confidence, have experienced a limited recovery.
- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. These effects will dampen economic growth through the second half of 2016.
- UK CPI inflation (currently 0.6%year/year) will rise close to target over the coming year as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies.
- The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- There is a debatable benefit to further interest rate cuts (particularly with regard to financial stability). Negative Bank Rate is currently perceived by policymakers to be counterproductive, but there is a possibility of close-to-zero Bank Rate. QE will be used to limit the upward movement in bond yields.
- Following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than a few months ago. However, financial market volatility is likely at various points because the stimulus has only delayed the fallout from the build-up of public and private sector debt (particularly in developing economies, e.g. China).

Appendix B
Forecast Treasury and Prudential Indicators as at 30th September 2016

Prudential Indicator	2016/17 Indicator	Quarter 2 – Forecast
Authorised limit for external debt	----- £743.000m	-----
Operational boundary for external debt	----- £723.000m	-----
Gross borrowing	£490.861m	£491.929m
Capital Financing Requirement (CFR)	£692.978m	£688.334m*
Ratio of financing costs to net revenue streams: GF	10.17%	10.17%
HRA	39.07%	39.07%
Incremental impact of capital investment decisions:-		
a) Increase in council tax (band D) per annum.	£4.90p	-£13.61p*
b) Increase in average housing rent per week	£0.11p	£0.11p
Limit of fixed interest rates based on net debt	£713.000m	£296.272m
Limit of variable interest rates based on net debt	£30.000m	-£85.201m
Principal sums invested > 364 days	£200.000m	£47.130m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 15% Min. 0%	0.5%
12 months to 2 years	Max. 15% Min. 0%	0.8%
2 years to 5 years	Max. 50% Min. 0%	5.8%
5 years to 10 years	Max. 50% Min. 0%	12.9%
10 years and above	Max. 100% Min. 50%	80.0%

* Includes impact of 2015-16 capital programme slippage on schemes funded by Prudential (unsupported) Borrowing.