FAREHAM
BOROUGH COUNCIL

Report to the Executive for Decision
7 December 2015

Portfolio:	Policy and Resources
Subject:	Treasury Management Monitoring Report 2015/16
Report of:	Director of Finance and Resources
Strategy/Policy:	Finance Strategy
Corporate Objective:	A dynamic, prudent and progressive council

Purpose:
This report summarises the Council's investment activity up to 30 September 2015 and provides details of the Council's money market transactions.

Under the Code of Conduct that governs the operation of the money markets, it is not possible to make public details of specific transactions. For this reason, Appendix A is included in the confidential part of the agenda.

Executive summary:
This report gives the Executive the opportunity to review the treasury management activity up to 30 September 2015 along with the Treasury and Prudential Indicators.

The overall position is set out in the following table:

Investments	**Externally Managed £m**	**Internally Managed £m**	**Call Accounts £m**	**Total £m**
At 1 April 2015	**10.0**	**13.0**	**20.1**	**43.1**
New	4.0	17.0	63.4	84.4
Repaid	4.0	11.0	64.4	79.4
At 30 Sept 2015	**10.0**	**19.0**	**19.1**	**48.1**

The actual fixed term investments are set out in Appendix A with more detailed information set out in the briefing paper.

Performance for the first half of the year for the Treasury and Prudential Indicators are shown in detail in Appendix B. During the financial year to date the Council has operated within the treasury limits and Prudential Indicators.

Recommendation:
That the treasury management monitoring report for 2015/16 be noted.

Reason:
To inform the Executive of the Council's investment, borrowing and repayment activity up to 30 September 2015.

Cost of proposals:
Not applicable.

Appendices:

A: Externally and Internally Managed Investments (Confidential Appendix)
B: Half Year Treasury and Prudential Indicators
C: Treasury and Prudential Indicators Explained

Background papers:

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Executive Briefing Paper

Date:	07 December 2015
Subject:	Treasury Management Monitoring Report 2015/16
Briefing by:	Director of Finance and Resources
Portfolio:	Policy and Resources

INTRODUCTION

1. The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly. This report therefore ensures this Council is implementing best practice in accordance with the Code.

2. The total amount of fixed term investments and call accounts as at 30 September 2015 was £48.1 million, as summarised below. The movements during the year for fixed term investments are detailed in Appendix A.

Investments	**Externally Managed £m**	**Internally Managed £m**	**Call Accounts £m**	**Total £m**
At 1 April 2015	**10.0**	**13.0**	**20.1**	**43.1**
New	4.0	17.0	63.4	84.4
Repaid	4.0	11.0	64.4	79.4
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3. The £5 million increase in investments during the first half of the year was mainly due to the timing of precept payments, receipts of grants and progress on the Capital Programme.

INVESTMENT STRUCTURE

4. The structure of the investments at 30 September is shown in the following table. Over the past few years, most investments have been held on short periods to mitigate the risks that have been seen during the recession.

Investment Structure	External £m	Internal £m	Call £m	Total £m
For periods of less than 1 month	1.0	1.0	15.1	17.1
For periods of 1 to 3 months	2.0	0	4.0	6.0
For periods of 3 to 6 months	0	0	0	0
For periods of 6 to 12 months	5.0	18.0	0	23.0
For periods of 1 to 2 years	2.0	0	0	2.0
Total Investments at 30 Sept 2015				
Investments for periods < 365 days	8.0	19.0	19.1	46.1
Investments for periods 365+ days	2.0	0	0	2.0

5. Throughout this period of uncertainty, officers have been taking advice from the Council's treasury advisor, Capita Asset Services, to ensure that decisions are taken in light of the latest facts at the time. This has given rise to lower interest rates being secured but this is the lowest priority consideration compared to the security of investments and the liquidity of cash flow.

6. The Council's fixed term investments are partly managed externally by Tradition UK Ltd. The role of the broker is to determine the most appropriate investment option within criteria set by the Council. All cash transfers are made by Council officers and Executive approval has been given for the allocation of up to £13 million to the externally managed portfolio. This retains sufficient funds within the direct management of officers, while still ensuring that maximum yield is achieved from the longer term investments.

7. The investment structure is sufficient to meet the capital programme and other large cash outflows.

8. To increase the liquidity of the Council's investments, call accounts with Nat West, Santander, HSBC and Svenska Handelsbanken are being used. These accounts offer quick access to funds, however, they do attract a lower rate of interest than some of the fixed term investments shown in the table above.

9. The balance within each call account as at 30 September 2015 is set out in the following table:-

Call Accounts	£m
NatWest	5.1
Santander – 95 Day Notice	4.0
Svenska Handelsbanken	4.0
HSBC	6.0
Total	**19.1**

ECONOMIC UPDATE FROM TREASURY ADVISOR – CAPITA ASSET SERVICES

10. UK 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). Growth is expected to weaken 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 EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme.

11. 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, 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 CPI inflation has fallen to, or near to, zero over the last quarter.

12. The August Bank of England Inflation Report forecast was notably subdued in respect of inflation which was forecast to barely get 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 rejoin 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.

13. There are therefore considerable risks around whether inflation will rise in the near future as strongly as had previously been expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as was being forecast until recently. 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 we have seen in equity and bond markets in 2015 so far, could all potentially spill over to impact the real economies rather than just financial markets.

14. On the other hand, there are also concerns around the fact that the central banks of the UK and US have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are therefore arguments that they need to raise rates sooner, rather than later, so as to have ammunition to use if there was a sudden second major financial crisis. But it is hardly likely that they would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

15. The forecast for the first increase in Bank Rate has therefore progressively been pushed back during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

16. The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

INTEREST RATES

17. The base rate has remained at 0.5% since March 2009. The forecast for the timing of the first increase in Bank Rate by Capita Asset Services is quarter 2 of 2016.

18. In the current economic conditions, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns

are likely to remain low.

19. Actual investment income for 2014/15 was £710,760 with the budget for 2015/16 set at £599,900 for the General Fund and Housing Revenue Account.

BORROWING

20. The Council's external long term borrowing amounted to £40.2 million as at 1 April 2015. This is as a result of the Housing Revenue Account (HRA) reforms (£40m) and the Hampshire County Council interest free loan for Portchester Community Centre (£0.2m).

21. For the HRA reforms, the Council has taken out ten £4 million loans from the PWLB with duration of between 40 and 50 years at an average interest rate of 3.50% as detailed in the table below:-

Repayment Date	Loan Amount	Interest Rate
30/09/2052	£4m	3.52%
30/09/2053	£4m	3.51%
30/09/2054	£4m	3.51%
30/09/2055	£4m	3.51%
30/09/2056	£4m	3.50%
30/09/2057	£4m	3.50%
30/09/2058	£4m	3.50%
30/09/2059	£4m	3.49%
30/09/2060	£4m	3.49%
30/09/2061	£4m	3.48%
Total	**£40m**	**3.50% average**

22. Interest payable for 2015/16 is budgeted at £1,851,700 and will be met by the HRA. £1,400,400 relates to the PWLB loans and £451,300 for interest on internal borrowing between the General Fund and the HRA.

STRATEGY COMPLIANCE

23. The Council's Treasury Management Strategy Statement for 2015/16, which includes the Annual Investment Strategy 2015/16, was approved by the Council on 2 March 2015. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

24. The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs but also to seek out value available in higher rates in periods up to 2 years with highly credit rated financial institutions.

25. The compliance with the various elements of the strategy are set out in the following table:-

Compliance on Individual Elements	Yes/No	Notes
Borrowing only up to “supported” level	Yes	No borrowing during the first half of the year.
All investments with approved institutions	Yes	Treasury management advisors provide updated list of approved institutions weekly.
All individual investments within prescribed financial limits	Yes	There are currently 6 institutions where the total investment is at the maximum level. They are Lloyds, Barclays and HSBC, (£6m limit), Skipton BS, West Bromwich BS and Principality BS (£2m limit).

COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

26. 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 (affordable limits) were approved by the Executive at its meeting on 2 March 2015.

27. Performance for the first half of the year is shown in Appendix B and the purpose of each indicator is explained in more detailed in Appendix C. During the financial year to date the Council has operated within the treasury and prudential indicators.

RISK ASSESSMENT

28. In the current economic climate, there are risks that financial institutions holding Council investments could default and be unable to fulfil their commitments to repay the sums invested with them.

29. To help mitigate this risk, the Council maintains a list of approved institutions based on a grading system operated by the Council's treasury management advisers. Maximum limits are also set for investments with individual institutions.

Reference Papers:
2 March 2015 Executive Report - Treasury Management Strategy and Prudential Indicators 2015/16