Gloucester
City Council

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| **Meeting:** | **Audit and Governance Committee**<br>**Cabinet** | **21 November 2016**<br>**7 December 2016** |
| **Subject:** | **Treasury Management Update – Mid Year Report 2016/17** | |
| **Report Of:** | **Cabinet Member for Performance and Resources** | |
| **Wards Affected:** | **All** | |
| **Key Decision:** | **No**     **Budget/Policy Framework:** **No** | |
| **Contact Officer:** | **Jon Topping, Head of Finance** | |
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| **Appendices:** | **1. Prudential and Treasury Indicators**<br>**2. Interest rate forecasts** | |

**FOR GENERAL RELEASE**

## 1.0 Purpose of Report

1.1 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 (TMSS, annual and midyear reports). This report covers the six months 1st April 2016 to 20th September 2016 and therefore, ensures this Council is implementing best practice in accordance with the Code.

1.2 This report will highlight issues specific to the Council and also highlight interest rate forecasts as provided by the Council's treasury advisors Capita Asset Services.

1.3 The body of the report provides an overview of the Councils performance for the first half of 16/17;

- **Appendix 1** highlights the key performance indicators in line with the Councils Treasury Management Strategy.
- **Appendix 2** Interest Rate Forecast.

## 2.0 Recommendations

2.1 Audit and Governance Committee is asked to **RESOLVE**, subject to any recommendations it wishes to make to Cabinet, to note the contents of the report.

2.2 Cabinet is asked to **RESOLVE** that the contents of the report be noted.

## 3.0 Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 24th March 2016. It sets out the Council's investment priorities as being:

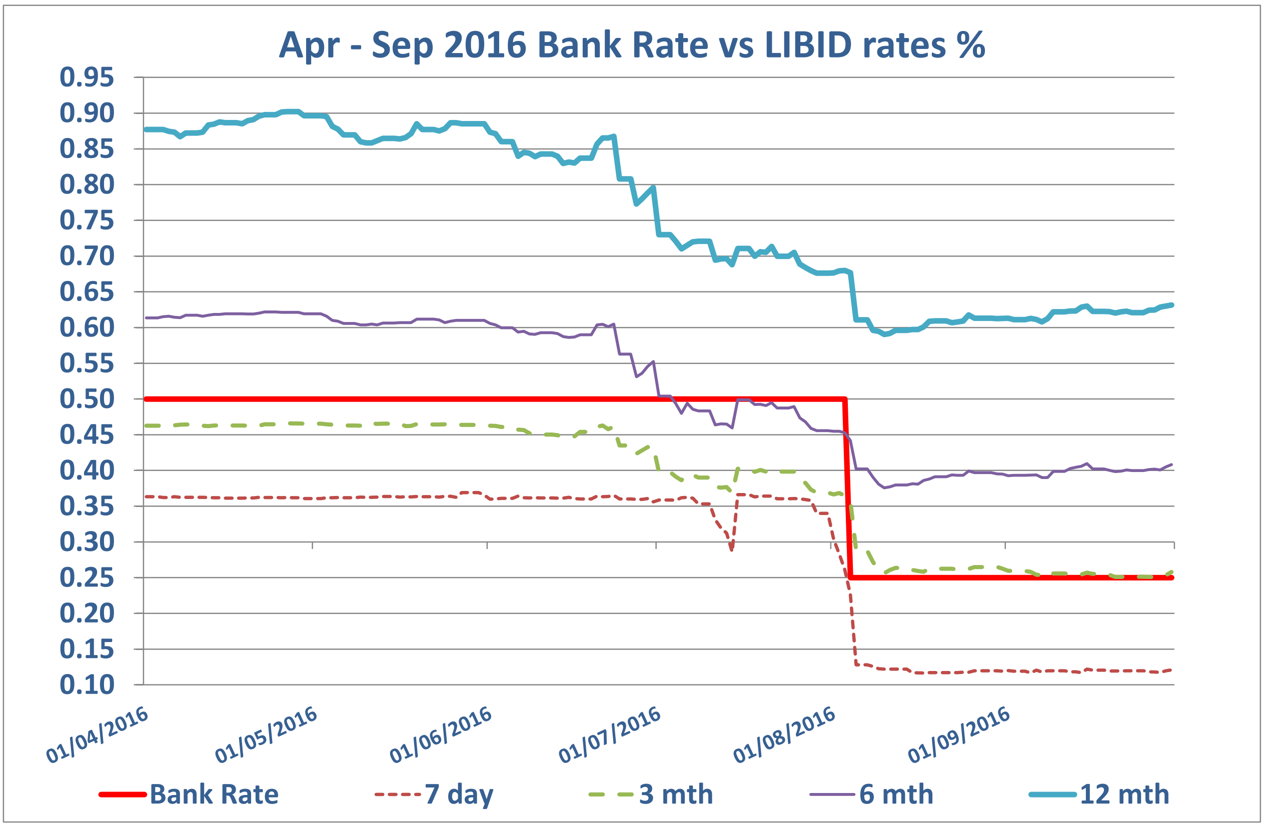
- Security of capital;
- Liquidity; and
- Yield

3.1 The Council will also aim to achieve the optimum return (yield) on its 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 periods up to 12 months, with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

3.2 Investment rates available in the market were broadly stable during the first half of the period but then took a slight downward path in the second half concluding with a significant drop after the referendum on a sharp rise in expectation of an imminent cut in Bank Rate and 'lower for longer' expectations thereafter. The average level of funds available for investment purposes during the period was £6.69M. 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. The Council does not hold cash balances for investment purposes (i.e. funds available for more than one month).

**Investment performance for the financial year to date as at 30th September 2016**

| Benchmark | Benchmark Return | Council Performance | Investment Interest Earned |
|---|---|---|---|
| 7 day | 0.28 | 0.42 | £13,896 |
| 1 month | 0.30 | N/A | N/A |
| 3 month | 0.38 | N/A | N/A |
| 6 month | 0.52 | N/A | N/A |
| 12 month | 0.76 | N/A | N/A |




As illustrated, the Council outperformed the benchmark by 14 bps.

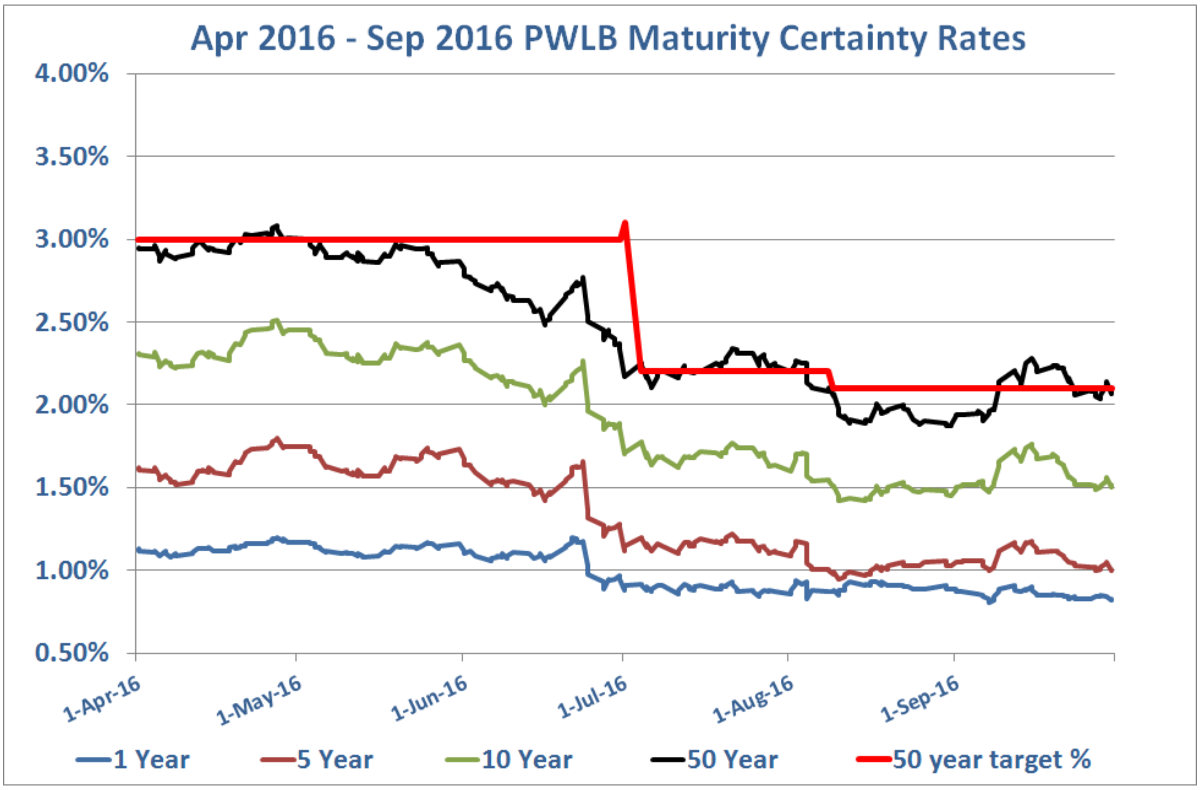
## 4.0 New Borrowing

4.1 As depicted in the graph below, there has been significant volatility in PLWB rates during quarter 1 culminating in a progressive fall in rates during the first three weeks in June as confidence rose that the polls were indicating a 'IN' result for the referendum, followed by a sharp rise in the run up to the referendum day as the polls swung the other way, followed by a sharp fall to the end of the month in anticipation that there is likely to be further quantitative easing purchases of gilts in the coming months. During the year to date, the 50 year PWLB target (certainty) rate for new long term borrowing started at 3.10% and ended at 2.10%.

4.2 No long term borrowing was undertaken during the period.

4.3 **PWLB certainty rates, for the financial year to the 30th 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** | 1.20% | 1.80% | 2.51% | 3.28% | 3.08% |
| **Date** | 27/04/2016 | 27/04/2016 | 27/04/2016 | 27/04/2016 | 27/04/2016 |
| **Average** | 0.99% | 1.33% | 1.92% | 2.69% | 2.46% |




4.4 **Borrowing in advance of need.**

The Council has not borrowed in advance of need during the period ended 30th September 2016.

## 5.0 Debt Rescheduling

5.1 Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted

PWLB new borrowing rates since October 2010. During the period ended 30th September 2016, no debt rescheduling was undertaken.

## 6.0 Compliance with Treasury and Prudential Limits

6.1 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) are included in the approved TMSS.

6.2 During the financial year to date the Council has operated within the treasury limits set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The Council debt profile is currently structured on short term borrowing. The Council is able to benefit from reduced costs associated with short term borrowing compared to longer term rates while operating within the Councils borrowing requirements, this strategy will continue to be reviewed in line with market expectations. The prudential and treasury Indicators are shown within appendix 1.

## 7.0 Other

7.1 The Council continued to maintain an under-borrowed position in 2016/17.

7.2 This under-borrowing reflects that the Council resources such as reserves and provisions will have reduced debt rather than be externally invested. This strategy is sensible, at this point in time, for two reasons. Firstly, there is no differential between the marginal borrowing rate and investment rate so there is nothing to be gained by investing Council resources externally. Secondly, by using the resources to reduce debt the Council will reduce exposure to investment counterparty risk.

7.3 The Council will continue to monitor its approach to under borrowing in light of market movement and future events.

7.4 The Council has utilised short term borrowing in 2016/17 as part of its overall borrowing strategy, this policy has allowed the Council to benefit from lower interest rates available over the short term, reducing borrowing costs significantly in the short term. Over our current 2016/17 borrowing requirement, the Council has been able to obtain short term borrowing at 0.35% compared to current long term rates at 1.5% for 10 year. Over this period the policy has reduced borrowing costs by £190k.

7.5 The Council will continue to monitor its approach to short term borrowing in accordance with our treasury advisor forecasts and future Council events which impact on the Council borrowing requirement.

## 8.0 Asset Based Community Development (ABCD) Considerations

8.1 This report notes the treasury management performance of the Council. There are no anticipated ABCD implications from this report.

**9.0 Financial Implications**

9.1 Contained in the report

(Financial Services have been consulted in the preparation this report.)

**10.0 Legal Implications**

10.1 There are no legal implications from this report

(One Legal have been consulted in the preparation this report.)

**11.0 Risk & Opportunity Management Implications**

11.1 There are no specific risks or opportunities as a result of this report

**12.0 People Impact Assessment (PIA):**

12.1 A PIA screening assessment has been undertaken and the impact is neutral. A full PIA is not required.

**13.0 Other Corporate Implications**

Community Safety

13.1 None

Sustainability

13.2 None

Staffing & Trade Union

13.3 None

**Appendix 1**

## Prudential and Treasury Indicators as at 30th September 2016

| Treasury Indicators | 2016/17 Budget £'000 | Mid-Year (Apr-Sep) Actual £'000 |
|---|---|---|
| **Authorised limit for external debt** | £30M | £30M |
| **Operational boundary for external debt** | £25M | £25M |
| **Gross external debt** | £25M | £15M |
| **Investments** | N/A | £0M |
| **Net borrowing** | £25M | £15M |

| | | |
|---|---|---|
| **Maturity structure of fixed and variable rate borrowing - upper and lower limits** | | |
| **Under 12 months** | 0% - 100% | 66.67% |
| **12 months to 2 years** | 0% - 100% | 0% |
| **2 years to 5 years** | 0% - 100% | 0% |
| **5 years to 10 years** | 0% - 100% | 33.33% |
| **10 years to 20 years** | 0% - 100% | 0% |
| **20 years to 30 years** | 0% - 100% | 0% |
| **30 years to 40 years** | 0% - 100% | 0% |
| **40 years to 50 years** | 0% - 100% | 0% |
| | | |
| **Upper limit of fixed interest rates based on net debt** | 100% | 66.67% |
| **Upper limit of variable interest rates based on net debt** | 100% | 33.33% |

**Appendix 2**

# INTEREST RATES FORECASTS

The Council'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% |

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% in November this year 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.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates. Our PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The overall balance of risks to economic recovery in the UK remains to the downside. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Weak capitalisation of some European banks.
- A resurgence of the Eurozone sovereign debt crisis.

- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a further flight to safe havens (bonds).

- UK economic growth and increases in inflation are weaker than we currently anticipate.

- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.