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|---|---|---|---|
| REPORT TO: | **AUDIT COMMITTEE** | | |
| DATE: | 28 November 2016 | | |
| TITLE: | **MID YEAR REVIEW TREASURY REPORT 2016/2017** | | |
| TYPE OF REPORT: | Review | | |
| PORTFOLIO(S): | Performance - Cllr Brian Long | | |
| REPORT AUTHOR: | Toby Cowper | | |
| OPEN/EXEMPT | Open | WILL BE SUBJECT TO A FUTURE CABINET REPORT: | *No* |

**REPORT SUMMARY/COVER PAGE**

PURPOSE OF REPORT/SUMMARY:

Summary

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011) and remains fully compliant with its requirements.

One of the primary requirements of the Code is:

Receipt by Council of an annual strategy report (including the annual investment strategy report) for the year ahead, a mid year review report and an annual review report of the previous year.

The Mid -Year Review Report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy
- The Council's capital expenditure (prudential indicators)
- An economic update for the first six months of 2016/2017 – Appendix 5

RECOMMENDATIONS:

Audit Committee is asked to review the report and the treasury activity.

REASONS FOR RECOMMENDATIONS:

The Council has formally adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011) and remains fully compliant with its requirements.

One of the primary requirements of the Code is:

Receipt by Audit Committee of an a mid year review report.

## 1. The 2016/2017 Mid Year Review

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Council's Code of Practice on Treasury Management require that the Audit Committee consider a Mid Year Review Report.

1.2 During the first 6 months of the year the Council maintained a cautious approach to investment and management of debt.

1.3 The Councils portfolio position as at 30 September 2016 was:

| | 31 March 2016 Actual £million | 30 September 2016 Actual £million |
|---|---:|---:|
| Borrowing | 17.20 | 13.10 |
| Investments | (28.30) | (28.36) |
| **Net Position** | **(11.10)** | **(15.26)** |

1.4 The Council held **£28.36m** of investments (including temporary cashflow) as at 30 September 2016 and the investment portfolio yield for the first six months of the year is 0.81**%** against a benchmark 0.13% (7 day LIBID – London Interbank Bid Rate).

Details of the 'Treasury Benchmarking Group' can be found in *Appendix 4,* and shows the Council has the highest return at the end of the second quarter in comparison with its members on the benchmarking group.

| Budgeted Interest Receivable | Actual Interest Received |
|---:|---:|
| (£144,000) | (£145,450) |

1.5 During the first 6 months of 2016/2017 interest on external debt was paid at an average rate of 3.39%.

| Budgeted Interest Payable | Actual Interest Paid |
|---:|---:|
| £232,500 | £228,654 |

Details of the investment portfolio as at the 30 September 2016 can be found in *Appendix 1*

Details of the borrowing portfolio as at the 30 September 2016 can be found in *Appendix 2*

## 2. Compliance with Treasury Limits

2.1 During the financial year to September 2016, the Council operated within the treasury limits and prudential indicators set out in the Council's Treasury Policy Statement 2016/2017 and annual Treasury Strategy Statement 2016/2017. The mid term review of the prudential indicators is shown in *Appendix 3*.

## 3. Mid Year Review Summary

- The Treasury Management Strategy Statement is still fit for purpose.

- Interest rates are predicted to fall to 0.1 in December 2016 and then not rise again until June 2018.

- The Council held £28.36m of investments as at 30 September 2016.

- The average rate of return on investments is 0.81% as at September. 2016

- The Council held £13.1m of external debt as at 30 September 2016.

- The Council is paying an average rate of 3.39% on its external debt. This can be broken down into an average of 3.81% for long term debt and an average of 2% for stort term debt

- During the first six months of the year, no debt rescheduling was undertaken.

- Council officers are continuing to investigate alternative options for investment where opportunities become available as an alternative to traditional investments. To date none of these investments have been taken up. A capital and property investment strategy is scheduled to be put forward at a future Cabinet meeting.

- The Assistant Director confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2016/2017.

- 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 and in compliance with the Council's Treasury Management Practices.

- Undertook benchmarking with other local Councils to ensure that experiences and opportunities were shared and investment instruments were consistent, while maintaining good credit quality and security *(Appendix 4)*.

## 4 Financial Implications

4.1 The financial implications of the borrowing and investment strategy are reflected in the financing adjustment figure included in the Financial Plan 2015/2020 approved at Cabinet on 2 February 2016 and updated as reported in the Budget Monitoring report.

## 5. Risk Management Implications

5.1 There are elements of risk in dealing with the treasury management function although the production and monitoring of such controls as prudential indicators and the treasury management strategy help to reduce the exposure of the Council to the market. The costs and returns on borrowing and investment are in themselves a reflection of risk as seen by the market forces.

## 6. Policy Implications

6.1 There are no changes in the Treasury Management policy at present.

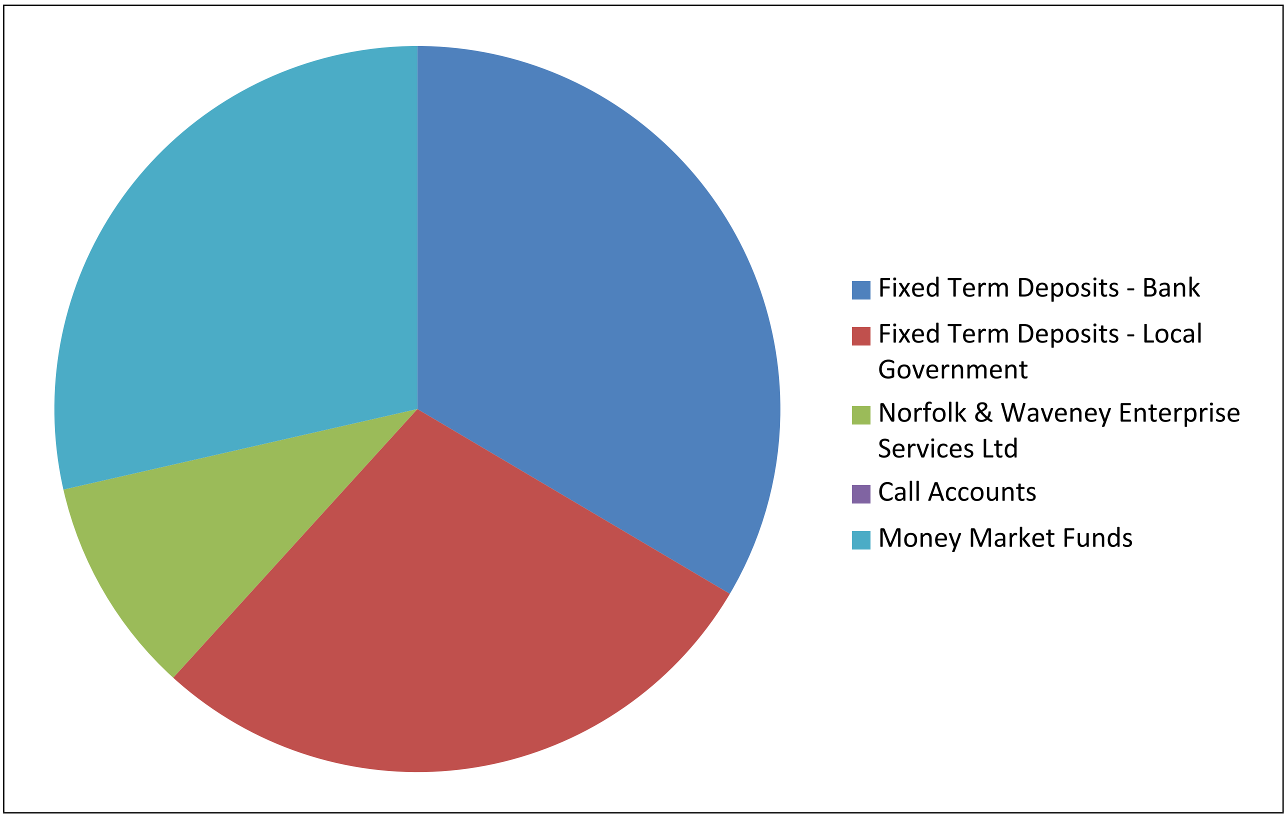
## 7. Statutory Considerations

7.1 The Council must set prudential indicators and adopt a Treasury Management Strategy and Annual Investment Strategy.

## 8. Access to Information

The Budget 2015/2020 – A Financial Plan
Capital Programme 2015/2020
Treasury Management Strategy and Annual Investment Strategy 2016/2017
Budget Monitoring reports 2016/2017
Capita Asset Services Monthly Investment Analysis Review
Investment Portfolio Benchmarking Analysis September 2016
Treasury Monthly Monitoring Reports

**Investment Portfolio as at 30 September 2016** **APPENDIX 1**




| Institution | Principal £ | Start Date | End Date | Rate % | Ratings |
|---|---|---|---|---|---|
| | | | | | |
| Norfolk & Waveney Enterprise Services Ltd | 2,500,000 | 27/03/2014 | | 1.80 | N/A |
| Santander | 4,000,000 | 10/12/2015 | | 1.15 | A |
| King & Shaxson – RBS | 2,500,000 | 22/05/2015 | 22/05/2017 | 1.33 | BBB+ |
| Qatar Bank | 3,000,000 | 01/06/2016 | 01/06/2017 | 1.05 | AA- |
| Fife Council | 3,000,000 | 12/11/2015 | 13/11/2017 | 0.95 | AAA |
| Bury Metro BC | 3,000,000 | 21/04/2016 | 23/04/2018 | 1.00 | AAA |
| West Cheshire & Chester Council | 2,000,000 | 20/11/2016 | 19/01/2018 | 0.99 | AAA |
| Gaywood Community Centre | 10,200 | 20/07/2016 | | | N/A |
| BNP Parabis MMF* | 3,000,000 | 20/07/2016 | | 0.38 | A+ |
| Legal and General MMF | 3,000,000 | 04/08/2016 | | 0.33 | A+ |
| Ignis MMF | 2,100,000 | 24/08/2016 | | 0.31 | A+ |
| **Total** | **28,360,201** | | | **0.81** | |

*MMF – denotes Money Market Fund used for daily cashflow purposes

**Borrowing Portfolio as at 30 September 2016** **APPENDIX 2**

| Institution | Principal £ | Start Date | End Date | Rate |
|---|---|---|---|---|
| Suffolk County Council Local Enterprise Partnership (LEP) | 2,500,000 | 27/03/2014 | 30/11/2018 | 1.80% |
| Barclays | 5,000,000 | 22/03/2007 | 21/03/2077 | 3.81% |
| Barclays | 5,000,000 | 12/04/2007 | 14/04/2077 | 3.81% |
| Public Works Loan Board | 600,000 | 15/09/2009 | 14/09/2019 | 2.92% |
| **Total** | **13,100,000** | | | **3.39%** |

**Prudential Indicators:** **APPENDIX 3**

| **Net borrowing and the CFR** | | |
|---|---|---|
| | **31 March 2016 Actual £million** | **30 September 2016 Actual £million** |
| Borrowing | 17.2 | 13.1 |
| Investments | (28.3) | (28.4) |
| **Net Position** | **(11.1)** | **(15.3)** |
| | | |
| **Capital Financing Requirement** | **18.0** | **25.1** (estimate for 2016/2017 year end) |

In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2016/2017. This essentially means that the Council is not borrowing to support revenue expenditure. The Council has complied with this prudential indicator.

**The Council's Capital Position and Associated Prudential Indicators**

The capital programme approved by Council on 2 February 2016 was updated for rephasing and amendments as part of the closedown of the accounts 2015/2016. The updated estimates were approved by Council on 28 June 2016 and are shown in the table below. The capital programme 2016/2017 has been revised as reported in the Monthly Monitoring reports.

| **Capital Expenditure**<br><br>**Service Head** | **Capital Programme 2016/2017 (Council 2 February 2016) £'000** | **Revised Capital Programme 2016/2017 (Council 28 June 2016) £'000** | **Expenditure as at 30 September 2016 £'000** |
|---|---|---|---|
| | | | |
| Major Projects | 18,764 | 19,983 | 4,727 |
| Central and Community Services | 1,933 | 2,223 | 475 |
| Chief Executive | 226 | 111 | 72 |
| Commercial Services | 2,478 | 2,987 | 957 |
| Environment and Planning | 12 | 16 | (5) |
| Resources | 0 | 0 | 0 |
| | | | |
| **Total Capital Programme** | **23,413** | **25,320** | **6,226** |

Capital Financing Requirement is defined as the underlying need to incur borrowing for capital purposes. The table below compares the original estimated CFR for year end 2016/2017 with the position as at year end 2015/2016.

| **Capital Financing Requirement**<br><br>**2016/2017 Original Estimate £m** | **Position as at 31/3/2016 £m** | **2016/2017 Revised Estimate £m** |
|---|---|---|
| 25.1 | 18.0 | 25.1 |

| Budget Related Prudential Indicators – Revised | | | |
|---|---|---|---|
| | **2016/2017 revised estimate** | **2017/18 estimate** | **2018/19 estimate** |
| **Capital Expenditure**<br>Approved at Cabinet 28 June 2016 | 25,320,630 | 23,377,290 | 13,320,760 |
| **Ratio of financing costs to net revenue stream**<br>(Equals net treasury cost ie cost of borrowing less the income from investments divided by the total of Government grant and total council tax). | 2.93% | 3.73% | 3.84% |
| **Capital Financing Requirement (CFR) as at 31 March** this reflects the Council's underlying need to borrow for capital purposes | £25,130 | £26,433 | £16,620 |

| Authorised / Operational Limit for external debt | | | |
|---|---|---|---|
| | **2016/2017 estimate £'000** | **2017/18 estimate £'000** | **2018/19 estimate £'000** |
| **Authorised Limit for external debt** | 35,000 | 35,000 | 32,000 |
| **Operational Boundary for external debt** | 30,000 | 30,000 | 27,000 |

- The Authorised Limit represents the maximum limit beyond which borrowing is prohibited, and needs to be set and revised by Members.

- The Operational Boundary for External Debt is a working practice limit that is set lower than the Authorised Limit. In effect the authorised limit includes a degree of contingency in case of circumstances arising that take the limit above the operational limit.

| Interest Rate Exposures (Limit on fixed and variable rate borrowing) | | | |
|---|---|---|---|
| | **2016/2017 Upper £** | **2017/2018 Upper £** | **2018/2019 Upper £** |
| **Limits on fixed interest rates based on net debt** | 35,000 | 35,000 | 32,000 |
| **Limits on variable interest rates based on net debt** | 20,000 | 20,000 | 20,000 |

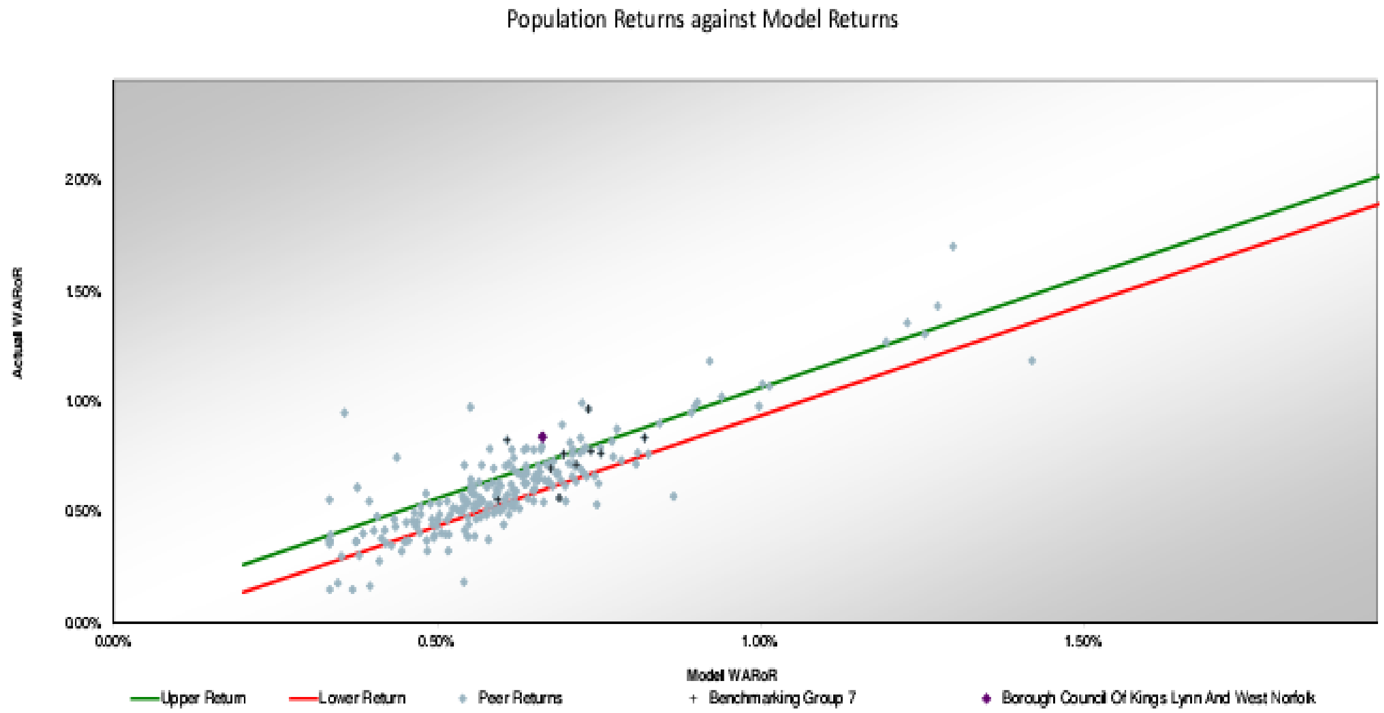
| Maturity Structure of fixed interest rate borrowing | | | |
|---|---|---|---|
| | **Lower** | **Upper** | **Portfolio Position as at 30 September 2016** |
| **Under 12 months** | 0% | 100% | 0% |
| **12 months to 2 years** | 0% | 100% | 0% |
| **2 years to 5 years** | 0% | 100% | 23.7% |
| **5 years to 10 years** | 0% | 100% | 0% |
| **10 years and above** | 0% | 100% | 76.3% |

**Treasury Benchmarking Group** **APPENDIX 4**

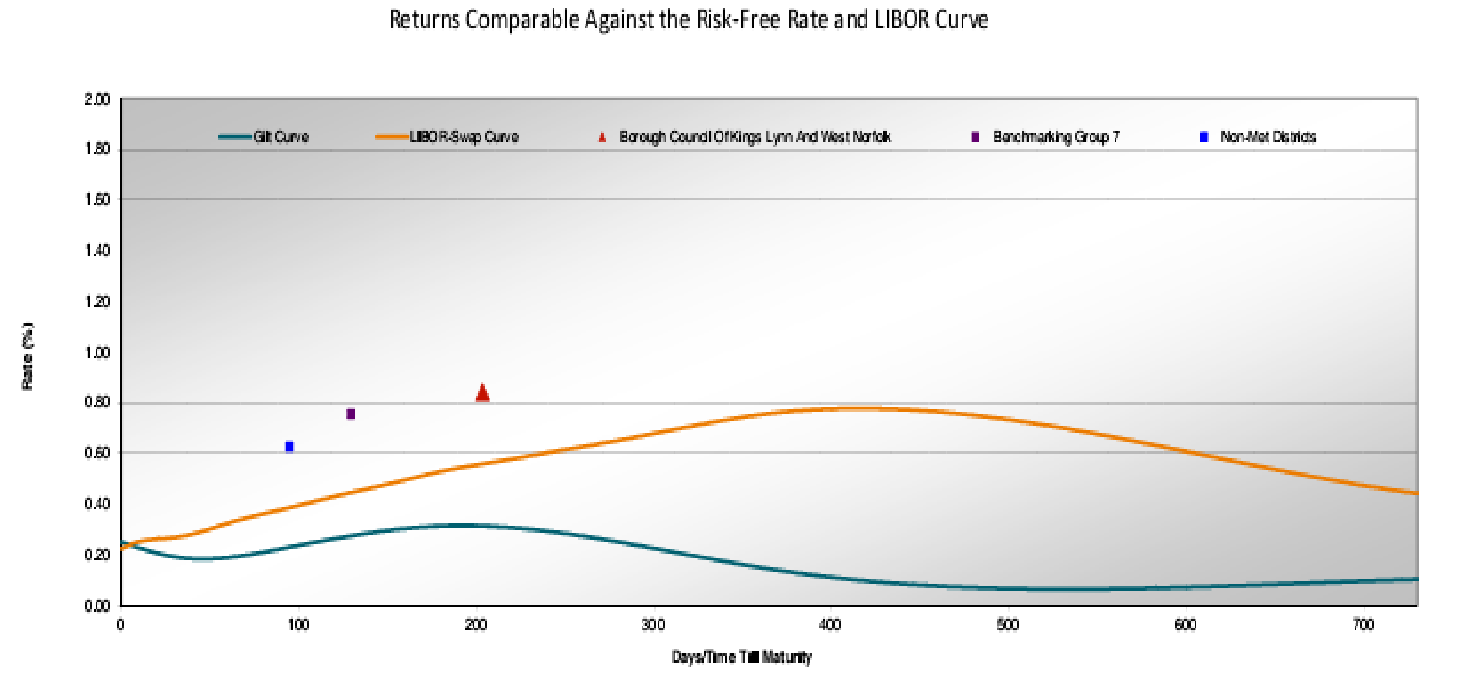
The Council is a member of a Treasury Benchmarking Group, where Capita Treasury clients from neighbouring authorities (including those in Norfolk, Suffolk and Cambridgeshire) meet to discuss treasury instruments relevant to their authority and discuss ideas for borrowing and investments.

All authorities want to try to maximise their returns, whilst maintaining good credit quality and security during the difficult financial climate. In addition to this, percentage rate returns are disclosed at each quarterly meeting.

The Councils return of 0.84% is the highest return for the end of the second quarter against the group with the average return being 0.76%.



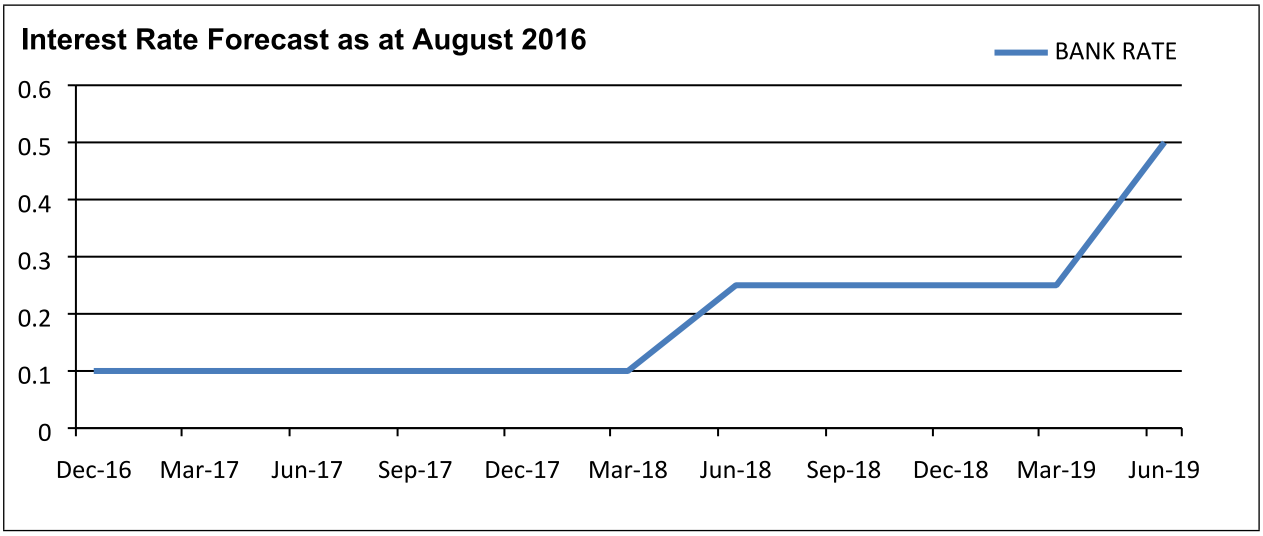

| | Actual WARoR | Model WARoR | Difference | Lower Bound | Upper Bound | Performance |
|---|---|---|---|---|---|---|
| Borough Council Of Kings Lynn And West Norfolk | 0.84% | 0.66% | 0.18% | 0.60% | 0.73% | Above |




| | WARoR | WAM | WATT | WARisk | Gilt | LIBOR-Swap | Difference Gilt | Difference LIBOR-Swap | Model Bands | Performance |
|---|---|---|---|---|---|---|---|---|---|---|
| Borough Council Of Kings Lynn And West Norfolk | 0.84% | 203 | 343 | 2.2 | 0.31% | 0.56% | 0.53% | 0.28% | 0.60% - 0.73% | Above |
| Benchmarking Group 7 | 0.76% | 129 | 240 | 4.5 | 0.27% | 0.44% | 0.48% | 0.31% | 0.64% - 0.76% | Inline |
| Non-Met Districts | 0.63% | 94 | 179 | 3.9 | 0.23% | 0.38% | 0.40% | 0.24% | 0.56% - 0.69% | Inline |

**APPENDIX 5**

**Economic update – Provided by Capita Asset Services as at September 2016**




1.1 UK GDP (Gross Domestic Product) 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. 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, 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.

1.2 The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The 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 Phillip 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.

1.3 The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI (Consumer Price Index) 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 and, 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. However, the MPC (Monetary Policy Committee) 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.

1.4 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 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, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

1.5 In the Eurozone, the ECB (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 (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 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. 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.

1.6 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.

1.7 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% |

1.8 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 (Bank of England), 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.

1.9 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.

1.10 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.

1.11 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.