TREASURY MANAGEMENT UPDATE

QUARTER 3 (OCTOBER-DECEMBER), 2015-16

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 fourth quarter of 2015 (calendar year) saw:

- UK economic growth softened but remained reasonably robust;
- Global GDP concerns remain prevalent;
- Inflation pressure remains low;
- Labour market showed continued wages growth;
- The MPC maintained the stance of monetary policy.

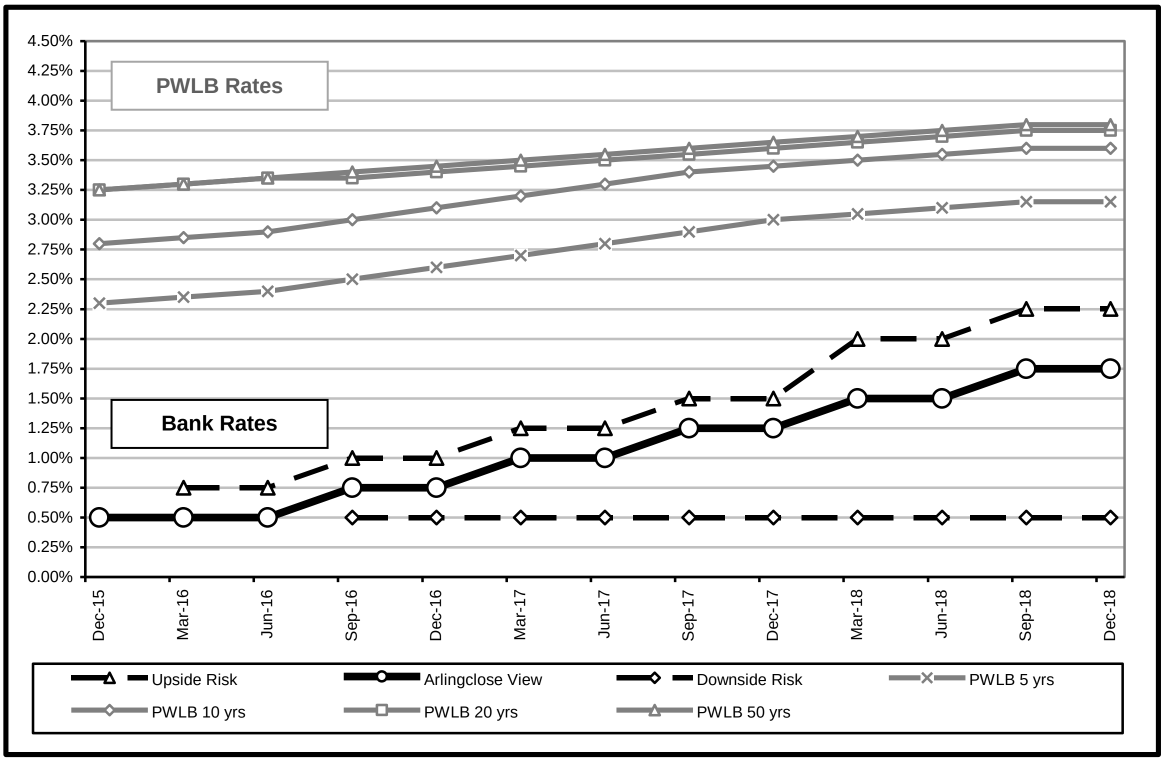
Interest rate forecast:

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

	Dec 2015	Mar 2016	Jun 2016	Sept 2016	Dec 2016	Mar 2017	Jun 2017	Sept 2017	Dec 2017	Mar 2018	Jun 2018	Sept 2018	Dec 2018
Official Bank Rate													
Upside Risk		0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%	0.50%
Arlingclose View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
Downside Risk				(0.25%)	(0.25%)	(0.50%)	(0.50%)	(0.75%)	(0.75%)	(1.00%)	(1.00%)	(1.25%)	(1.25%)
Public Works Loans Board Implied Rates (Certainty Rate discount applied)													
5 years	2.30%	2.35%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.05%	3.10%	3.15%	3.15%
10 years	2.80%	2.85%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.45%	3.50%	3.55%	3.60%	3.60%
20 years	3.25%	3.30%	3.35%	3.35%	3.40%	3.45%	3.50%	3.55%	3.60%	3.65%	3.70%	3.75%	3.75%
50 years	3.25%	3.30%	3.35%	3.40%	3.45%	3.50%	3.55%	3.60%	3.65%	3.70%	3.75%	3.80%	3.80%

Chart 1: Interest Rate Forecast



There are many risks to the forecast set out above, principally around the timing and pace of rate rises, and a full listing of underlying assumptions is attached at Appendix A. Budget estimates prudently include sensitivity analysis of the impact that a delayed economic recovery would have on the Council.

Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 18th February 2015. 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 31st December 2015.

Table 2: Forecast Investment Maturity Position at 31st December 2015

Period	Product type / Maturity	Amount	
		£	**%**
Instant Access	Banks	£7,009,112	2.4
	Money Market Funds	£63,200,000	22.0
		£70,209,112	**24.4**
Fixed Term – Building Societies	0-3 months to maturity	**£1,000,000**	**0.4**
Fixed Term - Local Authorities	3-6 months to maturity	£20,000,000	7.0
	9-12 months to maturity	£22,000,000	7.7
	>12 months to maturity	£20,500,000	7.1
		£62,500,000	**21.8**
Certificates of Deposit – Banks	0-3 months to maturity	£17,800,000	6.2
	3-6 months to maturity	£74,000,000	25.8
	6-9 months to maturity	£36,200,000	12.6
		£128,000,000	**44.6**
Floating Rate Bonds – Banks	3-6 months to maturity	**£5,048,156**	**1.7**
Covered Bonds – Fixed Rate	2-3 years to maturity	**£5,532,918**	**1.9**
Covered Bonds – Floating Rate	2-3 years to maturity	**£5,002,788**	**1.7**
Pooled Funds – Property	4-5 years to maturity*	**£10,041,068****	**3.5**
Total Investment Portfolio		**£287,334,042**	**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 meet this commitment.

** Forecast book value of investment

Investment rates available in the market continue to be low. Investment balances at the 31st December 2015 are forecast to be £287.334m. 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 to be £298.1m (£295.3m year-to-date).

Balances are forecast to fall to circa £250m by 31st March 2016 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.

Table 3: Forecast Benchmark Performance – Q3

Benchmark	Benchmark Return	Council Performance
3 month LIBID	0.54%	0.75%

As illustrated, the authority is forecast to outperform against the benchmark by 21 basis points. 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 forecast existing borrowing as at 31st December 2015.

Table 4: Forecast Borrowing Profile as at 31st December 2015

	Borrowing	
	£m	**%**
Under 12 months	9.428	1.90
1-2 years	2.520	0.51
2-5 years	35.671	7.19
5-10 years	56.288	11.34
Over 10 years	392.274	79.06
	496.181	**100.00**

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.

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 18th February 2015.

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 UK economic recovery softened in Q3 2015 but remained reasonably robust; the first estimate for the quarter was 0.5% and year-on-year growth fell slightly to 2.3%. Negative construction output growth offset fairly strong services output, however survey estimates suggest upward revisions to construction may be in the pipeline.

- Household spending has been the main driver of GDP growth through 2014 and 2015 and remains key to growth prospects. Consumption will continue to be supported by real wage and disposable income growth.

- Annual average earnings growth was 3.0% (including bonuses) in the three months to August. Given low inflation, real earnings and income growth continue to run at relatively strong levels and could feed directly into unit labour costs and households' disposable income. Improving productivity growth should support pay growth in the medium term. The development of wage growth is one of the factors being closely monitored by the MPC.

- Business investment indicators continue to signal strong growth. However the outlook for business investment may be tempered by the looming EU referendum, increasing uncertainties surrounding global growth and recent financial market shocks.

- Inflation is currently very low and, with a further fall in commodity prices, will likely remain so over the next twelve months. The CPI rate is likely to rise towards the end of 2016.

- China's growth has slowed and its economy is performing below expectations, which in turn with dampen activity in countries with which it has close economic ties; its slowdown and emerging markets weakness will reduce demand for commodities. Other possible currency interventions following China's recent devaluation will keep sterling strong against many global currencies and depress imported inflation.

- Strong US labour market data and other economic indicators suggest recent global turbulence has not knocked the American recovery off course. Although the timing of the first rate rise in official interest rates remains uncertain, a rate rise by the Federal Reserve seems significantly likely in December given recent data and rhetoric by committee members.

- Longer term rates will be tempered by international uncertainties and weaker global inflation pressures.

Appendix B

Treasury and Prudential Indicators as at 31st December 2015

Prudential Indicator	2015/16 Indicator	Quarter 3 – Forecast
Authorised limit for external debt	----- £591.000m	-----
Operational boundary for external debt	----- £571.000m	-----
Gross borrowing	£524.146m	£496.181m
Investments (quarter average)	£250.000m	£287.334m
Net borrowing	£274.146m	£208.847m
Capital Financing Requirement (CFR)	£541.727	£558.775m
Ratio of financing costs to net revenue streams: GF	11.17%	9.25%
HRA	41.14%	41.14%
Incremental impact of capital investment decisions:-		
a) Increase in council tax (band D) per annum.	(£0.01p)	£0.95p
b) Increase in average housing rent per week	£0.00p	£0.00p
Limit of fixed interest rates based on net debt (average)	£561.000m	£285.149m
Limit of variable interest rates based on net debt (average)	£30.000m	-£76.302m
Principal sums invested > 364 days	£200.000m	£41.077m
Maturity structure of borrowing limits:-		
Under 12 months	Max. 15% Min. 0%	1.90%
12 months to 2 years	Max. 15% Min. 0%	0.51%
2 years to 5 years	Max. 50% Min. 0%	7.19%
5 years to 10 years	Max. 50% Min. 0%	11.34%
10 years and above	Max. 100% Min. 50%	79.06%