Agenda Item No:	**15**	Fenland CAMBRIDGESHIRE
Committee:	Council	
Date:	18 December 2014	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2014/15	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2014/15.

2 Key issues

- The Treasury Management Mid-Year Review 2014/15 as considered by Cabinet on 18 December 2014 and by Corporate Governance Committee on 2 December 2014 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2014/15. All activities have been conducted in accordance with the approved strategy and policies.
- Prudential indicators for, the Capital Financing Requirement (CFR), gross borrowing and the capital position have been revised.
- Changes to the credit methodology following the removal of implied Government support given to financial institutions.
- 2014/15 continues to be a challenging year and the report highlights the success in maximising investment income whilst ensuring the security and liquidity of the Council's investments.

3 Recommendations

It is recommended that:-

- Members note the report.

It is recommended by Cabinet and Corporate Governance Committee that:-

- The increase in the CFR, gross borrowing and the capital prudential indicators (paragraph 4) be approved.
- Changes to credit methodology (paragraph 5) be approved.

Agenda Item No:	6	
Committee:	Corporate Governance Committee	
Date:	2 December 2014	
Report Title:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review 2014/15	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to review the Council's Treasury Management activity for the first six months of 2014/15.

2 Key issues

- The Council has operated within its Treasury Management Strategy Statement (TMSS), Annual Investments Strategy and treasury limits and prudential indicators set by Council for the first six months of 2014/15.
- Prudential indicators for, the Capital Financing Requirement (CFR), gross borrowing and the capital position have been revised.
- Interest rates have continued at historically low rates throughout this year.
- Investment income received for the first six months of 2014/15 is £88k (£103k to end of October). The 2014/15 budgeted outturn of £170k is projected to be achieved.
- Overall interest rate achieved from investments for the first six months of 2014/15 was 0.78% (benchmark 7 day LIBID uncompounded rate is 0.35%).
- Changes to the credit methodology following the removal of implied Government support given to financial institutions.

3 Recommendations

It is recommended that:-

- Members note the report.

It is recommended to Council that:-

- The increase in the CFR, gross borrowing and the capital prudential indicators (paragraph 4) be approved.
- Changes to credit methodology (paragraph 5) be approved.

Wards Affected	All
Portfolio Holder(s)	Councillor Chris Seaton, Portfolio Holder for Finance
Report Originator(s)	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper (s)	Capita Asset Services template Cabinet Report 27 February 2014 - General Fund Budget 2014/15 and Capital Programme 2014/17 Cabinet Report 18 December 2014 - Draft Medium Term Financial Strategy and General Fund Budget 2015/16

Report:

1 Introduction

3.1 Treasury management is defined as “The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.”

3.2 The Council complies with the requirements of The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice 2011.

3.3 The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council’s treasury management activities.
- Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
- Receipt by full Council of an annual Treasury Management Strategy Statement, including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a mid-year Review Report and an Annual Report covering activities during the previous year.
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Council of the role of scrutiny of treasury management strategy and policies (including Mid-year Review Report) to a specific named body. For this Council the delegated body is Corporate Governance Committee.

3.4 This mid-year report has been prepared in compliance with CIPFA’s Code of Practice on Treasury Management and covers the following:

- an economic update for the first six months of 2014/15;
- a review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- the Council’s capital position;
- a review of the Council’s investment portfolio for 2014/15;
- a report of the Council’s borrowing strategy for 2014/15;
- a report of debt rescheduling during 2014/15;
- a review of compliance with Treasury and Prudential Limits for 2014/15.

2 Economic Update

2.1 After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting and particularly of manufactured goods.

2.2 The overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increase in Bank Rate. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable.

2.3 There needs to be major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

2.4 Consumer Price Index (CPI) fell sharply, reaching 1.2% in September (1.3% in October), the lowest rate since 2009. Forward indicators are that inflation is likely to fall further in 2014 to possibly 1%. Overall markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to 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.

2.5 The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement and by an additional £24bn, as announced in the March 2014 Budget, which also forecast a return to a significant budget surplus (of £5bn) in 2018/19. However monthly public sector deficit figures have disappointed so far in 2014/15.

2.6 Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy. It is therefore possible over the next few years that levels of Government debt to GDP ratios could continue to rise for some countries.

2.7 Prospects for interest rates and borrowings over the medium term are shown below.

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
5yr PWLB rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

3 Treasury Management Strategy Statement and Annual Investment Strategy Update

3.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Council on 27 February 2014. Changes to the TMSS since February are an increase in the Capital Financing Requirement (CFR), gross borrowing and capital prudential indicators detailed in paragraph 4 and amendments to the methodology used to support the Council's creditworthiness policy, detailed in paragraph 5.

4 The Council's Capital Position

4.1 This part of the report is structured to update:

- the Council's capital expenditure plans;
- how these plans are being financed;
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- compliance with limits in place for borrowing activity.

4.2 This table shows the revised estimates for capital expenditure and financing of the capital programme and the changes since the budget was approved.

Capital Programme	**2014/15 Original Estimate £000**	**2014/15 Revised Estimate £000**
Forecast Capital Expenditure	**2,650**	**3,499**
Financed by:		
Capital Receipts	410	800
Capital Grants	456	1,238
Capital Reserves	1,784	1,461
Total Financing	**2,650**	**3,499**

4.3 The main changes to the capital programme approved in February 2014 are the enhancement scheme at George Campbell leisure centre and the Whittlesey bus terminal, both schemes have secured external funding which is shown within capital grants. The remaining changes relate to re-profiling of expenditure and capital resources between years.

4.4 The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period; this is termed the Operational Boundary.

Prudential Indicators	2014/15 Original Estimate £000	2014/15 Revised Estimate £000
Capital Financing Requirement	186	665
External Debt / Operational Boundary		
Borrowing	10,000	10,000
Other Long Term Liabilities Finance Leases	2,000	2,000
Total Debt 31 March	**12,000**	**12,000**

4.5 The Council's revised estimate for CFR is £479k higher than the original estimate. This reflects the decision to lease three new refuse vehicles. Whilst this increases the CFR and therefore the Council's borrowing requirement, this type of lease includes a borrowing facility so the Council is not required to separately borrow to fund these leases. The Council has made provision to repay this lease liability in the General Fund revenue budget.

4.6 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt, does not, except in the short term, exceed the total CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Limits to Borrowing Activity	2014/15 Original Estimate £000	2014/15 Revised Estimate £000
Gross Borrowing	7,800	7,800
Plus Other Long Term Liabilities Finance Leases	180	660
Gross Borrowing	**7,980**	**8,460**
Capital Financing Requirement	186	665

4.7 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/2014) currently attracting excessive premiums (£2.8m at the time of writing this report) if it were prematurely repaid, it is not financially advantageous for the Council to fully comply with this prudential indicator.

4.8 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit, which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level for borrowing which, while not desired could be afforded in the short term but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised Limit for External Debt	2014/15 Original Estimate £000	2014/15 Revised Estimate £000
Borrowing	15,000	15,000
Plus Other Long Term Liabilities Finance Leases	2,000	2,000
Total Borrowing	**17,000**	**17,000**

4.9 The Corporate Director & Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with the above prudential indicators.

5 Investment Portfolio

5.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in section 2, 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 Funding for Lending Scheme has reduced market investment rates even further. The potential for a prolonging of the 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.

5.2 The Council held investments of £22.95m as at the 30 September 2014 (£16.45m at 31 March 2014) and the investment portfolio yield for the first 6 months of the year is 0.78% against a benchmark (7 day LIBID uncompounded rate) of 0.35%.

5.3 The Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15. The Council has achieved investment income of £88k to 30 September 2014 (£103k to end of October). The 2014/15 budgeted outturn of £170k is projected to be achieved.

5.4 The Council's current investment counterparty criterion was approved in the TMSS in February 2014 and has met the requirements of the treasury management function to date.

5.5 The Council creditworthiness policy is based on a sophisticated modelling approach supported by Capita Asset Services (the Council's treasury management advisors), the basis of which utilises credit ratings from the three credit ratings agencies- Fitch, Moody's and Standard & Poor's. This credit rating information is supported by additional information including Credit Default Swaps (CDS) and other market information.

5.6 It has been necessary to make changes to the methodology due to pending amendments the three ratings agencies have indicated they are likely to make. These changes are to remove "uplifts", this rating was provided to some institutions due to the implied levels of sovereign support through the financial crisis.

5.7 It is important to stress that the rating agencies changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of support that has been built into the ratings through the financial crisis. The eventual removal of implied Government support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

5.8 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of the sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term Ratings. As such there is no point monitoring both Long Term and these "standalone" ratings.

5.9 As a result of these changes, the credit element of our future methodology will focus solely on the short and long term ratings of an institution. Rating Watch and Outlook Information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken but a change to the use of Fitch and Moody's ratings. We will continue to utilise CDS prices as an overlay to ratings in our new methodology.

6 Borrowing Strategy

6.1 No new borrowing has been undertaken in the first six months and none is anticipated during the remainder of this financial year, as stated in the TMSS report approved by Council on 27 February 2014.

7 Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2014/15.