Cheltenham Borough Council
Cabinet – 8th December 2015
Council – 14th December 2015
Treasury Mid-Term Report 2015/16

Accountable member	**Finance & Community Development , John Rawson**
Accountable officer	**Section 151 Officer, Paul Jones**
Accountable scrutiny committee	**Economy & Business Improvement**
Ward(s) affected	**None**
Key Decision	**Yes**
Executive summary	The Treasury Management Strategy for 2015/16 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (revised 2011), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements.
Consultation	The Treasury Management Panel have considered this report on 23rd November 2015.
Recommendations	**Treasury Management Panel approves the following recommendation to Cabinet/Council:** **1. Note the contents of the summary report of the treasury management activity during the first six months of 2015/16.**

Financial implications	All financial implications are detailed throughout the report **Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk, 01242 264337**
Legal implications	None specific arising from the report recommendations. **Contact officer: Peter Lewis, peter.lewis@tewkesbury.gov.uk, 01242 264216**

HR implications (including learning and organisational development)	No direct HR implications arising from this report **Contact officer: Julie McCarthy, julie.mccarthy@cheltenham.gov.uk. 01242 264355**
Key risks	see appendix 2
Corporate and community plan Implications	None
Environmental and climate change implications	None

1. Background

1.1 The Treasury Management Strategy for 2015/16 has been developed by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (revised 2011), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements, one of which is the provision of a Mid-year report to Members.

2. Economic update for the first six months

2.1 The following key points have been provided by the councils Treasury Advisors, Capita Treasury Solutions.

2.2 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, although the pace of reductions was eased in the May Budget. 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. Investment expenditure is also expected to support growth. However, since the report was issued, the Purchasing Manager's Index, (PMI), for services on 5 October would indicate a further decline in the growth rate to only +0.3% in Q4, which would be the lowest rate since the end of 2012. In addition, worldwide economic statistics and UK consumer and business confidence have distinctly weakened so it would therefore not be a surprise if the next Inflation Report in November were to cut those forecasts in August.

2.3 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 re-join 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.

2.4 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, especially given the 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, which could potentially spill over to impact the real economies rather than just financial markets.

3. Portfolio position 1/4/2015 to 30/9/2015

Movements in the Council's borrowing during the first six months of 2015/16 financial year can be seen in the table below. Long term loans are deemed to be those repayable over a period of more than one year.

Source of Loan **Temporary Borrowing**	**Balance at 1 April 2015 £**	**Raised during Apr-Sept £**	**Repaid during Apr-Sept £**	**Balance at 30 Sept 2015 £**
- Local Authorities	0	13,020,000	13,020,000	0
Temporary Investment	21,000	0	0	21,000
Total Short Term Borrowing	**21,000**	**13,020,000**	**13,020,000**	**21,000**
Long Term Borrowing				
- Public Works Loan Board	43,030,000	6,950,000	256,270	49,723,730
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	**58,930,000**	**6,950,000**	**256,270**	**65,623,730**
Total External Borrowing	**58,951,000**	**19,970,000**	**13,276,270**	**65,644,730**

3.1 In February 2015 the Council's borrowing costs for 2015/16 was set to be £2,067,400. This is now forecast to come in at £2,169,000 for the year, an increase of £101,600. The increase is due to an additional £4.75m borrowed from the PWLB to finance the purchase of Delta Place. This has increased borrowing costs by a further £83,200 and an additional £18,400 is expected to be repaid back to the HRA for reserves and balances held within the council investment balances. These balances are expected to come in higher than what was estimated in February 2015.

3.2 The PWLB remains an attractive source of borrowing for the Council as it offers flexibility and control. Due to downward moves in gilt yields in the first quarter, this resulted in PWLB rates falling across all maturities due to fear around the slowdown in China and Japan. In May 2015 a loan of £2.2m was taken out with the PWLB for 30 years at a rate of 3.08% on behalf of Cheltenham Borough Homes. The loan is cost neutral for the Council as Cheltenham Borough Homes are repaying the Council in line with the repayment schedule.

3.3 As highlighted in paragraph 3.1 the Council purchased Delta Place in June 2015 and went and borrowed £4.75m from the PWLB.

The loans drawn were:

Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1.5m	Fixed interest rate	2.80%	15 years
PWLB	£1.75m	Fixed interest rate	3.07%	20 years
PWLB	£1.5m	Fixed interest rate	2.16%	10 years

4. Investments

The DCLG's Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2015/16 approved by Council on the 13th February 2015. This restricted new investments to the following

Investment	**Max Sum per institution/group**	**Maximum period**
Debt Management Agency Deposit Facility* (DMADF) • this facility is at present available for investments up to 6 months	UNLIMITED	6 months
UK Government Gilts	£2m	2 years
UK Government Treasury Bills	UNLIMITED	1 year
Term deposits with the UK government or with UK local authorities (i.e. local authorities as defined under Section 23 of the 2003 Act) with maturities up to 1 year	£7m	2 years
Term deposits with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 1 year (UK & Non-UK)	£7m	1 year
Money Market Funds with UK/Ireland/Luxembourg domiciled	£1m	1 year

Corporate Bonds held in a broker's nominee account (King & Shaxson Ltd)	£2m	2 years to maturity
T-Bills issued by the DMO (Government)	UNLIMITED	1 year
Certificates of deposit (CD's) issued by banks and building societies covered by UK Government (explicit) guarantee	£7m	2 years

This Council applies the creditworthiness service provided by Capita. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

4.1 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 0.50% Bank Rate. As part of the 2015/16 Treasury Management Strategy investments have only been those which met the lending criteria set, and up to a maximum period of one year. Treasury officers have kept to this strategy for the period reported on. Given this risk environment, investment returns are likely to remain low.

4.2 **Investments -** Movements in the Council's investment portfolio during the first six months of 2015/16 can be seen in the table below.

Source of Loan Short term Lending	Balance at 1 April 2015 £	Raised during Apr-Sept £	Repaid during Apr-Sept £	Balance at 30 Sept 2015 £
Bank – Term Deposit	9,000,000	7,600,000	12,900,000	3,700,000
Building Societies	3,000,000	6,300,000	5,000,000	4,300,000
Call A/C's	6,590,000	69,200,000	69,910,000	5,880,000
Local Authorities	0	1,000,000	0	1,000,000
Glos Airport Ltd	210,000	0	35,000	175,000
Money Market Funds	2,000,000	2,000,000	2,000,000	2,000,000
Bonds	0	2,610,662	0	2,610,662
Total Short Term Lending	**20,800,000**	**88,710,662**	**89,845,000**	**19,665,662**

Icelandic Banks in administration	Balance at 1 April 2015 £	Raised during Apr-Sept £	Repaid during the year £	Balance at 30 Sept 2015 £
- Kaupthing Singer & Friedlander	522,486	0	0	522,486
- Glitnir	572,400	0	0	572,400
Total Icelandic Banks	**1,094,886**	**0**	**0**	**1,094,886**
Total External Investments	**21,894,886**	**88,710,662**	**89,845,000**	**20,760,548**

4.3 In February 2015 the Council's Investment income for 2015/16 was budgeted to be £60,000. The average cash balances representing the council's reserves and working balances, was £16.88m during the period this report covers. The Council anticipates an investment outturn of £123,200 at a rate of 0.70% for this financial year as treasury officers have been able to gain some good rates with the Bonds and Certificate of Deposits purchased. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16.

4.4 Included within the investments of £20.761m as at 30th September 2015, the Council has £1.095m deposited in the collapsed Icelandic banks.

4.5 Glitnir's Winding–up-Board made a distribution to priority creditors back in March 2012, which amounted to 78p in the pound. The remaining balance is held in an escrow account in Iceland. The Central Bank of Iceland is controlling the movement of Icelandic Krona's, so the Council has been unable to gain access to these funds. The Council is working with the Local Government Association (LGA) and Bevan Brittan (appointed solicitors) to recover the remaining amount.

4.6 Kaupthing Singer & Friedlander administrators have made distributions of 82.5p in the pound to date. Administrators currently estimate a total return of 85p-86.5p in the pound. No future date for the next dividend payment has been set yet.

5. Prudential Indicators

5.1 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement. Appendix 1 attached highlights the major indicators.

6. Outlook

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

6.1 Capita Asset Services undertook its last review of interest rate forecasts on 11 August shortly after the quarterly Bank of England Inflation Report. Later in August, fears around the slowdown in China and Japan caused major volatility in equities and bonds and sparked a flight from equities into safe havens like gilts and so caused PWLB rates to fall below the above forecasts for quarter 4 2015. However, there is much volatility in rates as news ebbs and flows in negative or positive ways and news in September in respect of Volkswagen, and other corporates, has compounded downward pressure on equity prices. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

Despite market turbulence since late August causing a sharp downturn in PWLB rates, the overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

7. Performance management

7.1 In compliance with the requirements of the Treasury Management CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first six months of 2015/16. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Report author	**Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk** **01242 264337**
Appendices	Prudential Indicators Appendix 1 Risk Appendix 2
Background information	Treasury Management Strategy, Council 13th February 2015