Appendix 1

Treasury Management Half Yearly Report - 2014/15

1. Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate security and liquidity initially before considering optimising investment return (yield).

The second main function of a treasury management service is the funding of an authority's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasions any debt previously drawn may be restructured to meet Council risk or cost objectives. Currently, however, the Council has not chosen to finance its capital investment by way of borrowing, so these activities are not presently engaged in.

Accordingly 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."

2. Introduction

The treasury management function is carried out in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) current Code of Practice on Treasury Management (revised November 2011). The original Code was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, and an Annual Report (stewardship report) covering activities during the previous year.
4. The production of a Mid-Year Review Report for scrutiny by Members. For this Council the delegated body to review treasury management and receive the Mid-Year Review Report is the Audit and Risk Committee.
5. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices. For this Council the delegated body is the Cabinet (for implementing) and the Audit and Risk Committee (for monitoring).
6. Delegation by the Council for the execution and administration of treasury management decisions. For this Council this is delegated to the Executive Director (Resources and Support Services).
7. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Finance, Resources and Partnership Committee.

This Mid-Year Review Report to members is intended to provide an update of the treasury management strategy and performance for the period April –September of this financial year. It has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2014/15 financial year to 30 September 2014
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2014/15

3. Economic Update – as provided by the Council's Treasury Management Advisors, Sector

United Kingdom economic performance to date and outlook

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 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), 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, both of which need to substantially improve on their recent lacklustre performance.

This 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 increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up.

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. There also needs to be a 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.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 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 Q1 or 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.

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.

Sector Interest Rate Forecast (as at 1st October 2014)

Sep 2014	Dec 2014	Mar 2015	Jun 2015	Sep 2015	Dec 2015	Mar 2016	Jun 2016	Sep 2016	Dec 2016	Mar 2017	June 2017
0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%

Sector undertook a review of its interest rate forecasts in mid-August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Full Council on 26 February 2014. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information where this is available. Currently investments are only being made with U.K. financial institutions.

Investments during the first six months of the 2014/15 financial year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 3 above, there is considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 26 February 2014 is still fit for purpose in the current economic climate.

5. Investment Portfolio 2014/15

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 3, 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. Indeed, the introduction of the Government's 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.

The Council held £3.39m of investments as at 30 September 2014 (£3.55m at 31 March 2014). Funds available for investment purposes can vary between £3m and £16m due to the large fluctuations in cash inflows and outflows during each month. Large cash inflows include council tax & business rate direct debits and the Housing Benefit subsidy from the Department for Work and Pensions. Large cash outflows include payment of the precepts to Staffordshire County Council, the Fire Authority and the Police, payment of salaries and payment of business rates to Central Government and the Staffordshire Business Rate pool.

The investment portfolio yield for the first six months of the year is 0.41% against a target of 0.70%. The Council's budgeted investment return for 2014/15 is £54,000. As at the end of the first 2 quarters of 2014/15 £16,650 of interest has been earned. Interest earned is below budget to date due to Banks and Building Societies being able to obtain cheap funding from the Government's Funding for Lending scheme (FLS). This has resulted in a significant drop in the rates being offered for investing in the market and led to a reduction in the interest rates being paid on all instant access and 30 day notice accounts. Additionally, a prepayment of pension lump sums payable in 2015/16 and 2016/17 amounting to £2.29m has been made – the total of which would otherwise have been available for investment.

A full list of investments held as at 30 September 2014 is shown in Annex A.

6. Borrowing Position 2014/15

It is not currently intended to borrow to finance capital investment in 2014/15. The only borrowing envisaged by the 2014/15 Treasury Management Strategy is temporary borrowing to cover short-term cash flow deficits. In fact no borrowing has taken place for the first half of the financial year.

7. Prudential Indicators 2014/15

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2014/15 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

Annex A

			INVESTMENTS OUTSTANDING As at 30/09/14			
ACK NO.	**BROKER**	**INT. RATE**	**DATE INVESTED**	**NAME OF BORROWER**	**PRINCIPAL**	**DATE MATURING**
5221A	RPM	0.49%	9/7/2014	NATIONWIDE BUILDING SOCIETY	1,500,000	9/10/2014
5223	Direct	0.57%	30/7/2014	HALIFAX BANK OF SCOTLAND	750,000	30/10/2014
5224	LCB	0.44%	3/9/2014	COVENTRY BUILDING SOCIETY	600,000	3/12/2014
					£ 2,850,000	
				BANK OF SCOTLAND INSTANT ACCESS ACCOUNT (Rate of Interest 0.40%)	**£ 540,000**	
				TOTAL INVESTMENTS	**£ 3,390,000**	
				HERITABLE BANK INVESTMENT		
5092	TRAD	6.10%	15/09/2008	**HERITABLE BANK *(Landsbanki)***	£ 142,309	14/09/2009

Payments of £403,250, £317,649, £155,396, £157,437, £103,815, £118,358, £156,863, £101,810, £104,919, £83,407, £95,089, £71,528, £68,207, £419,963 were received from the Heritable Bank administrators on 30th July 2009, 18th December 2009, 30th March 2010, 16th July 2010, 18th October 2010, 14th January 2011, 19th April 2011, 15th July 2011, 20th October 2011, 23rd January 2012, 20th April 2012, 20th July 2012, 17th January 2013 & 23rd August 2013 respectively.

Annex B

Treasury Management – Glossary of Terms

- **CDS –** 'Credit Default Swap' is an additional assessment of credit worthiness by providing a risk analysis of changes in credit quality as perceived by the market.

- **CIPFA –** the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.

- **CPI Inflation –** a measure that examines the weighted average of prices of a basket of consumer goods and services. The CPI is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

- **Credit Rating –** is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. The main rating agencies are Fitch. Standard and Poor's and Moody's.

- **Gilts –** the name given to bonds issued by the UK Government. Gilts are issued bearing interest at a specified rate, however, they are traded on the markets like shares and their value rises of falls accordingly. The 'yield' on a gilt is the interest paid divided by the market value of that gilt.

- **Gross Domestic Product (GDP) –** is the market value of all officially recognised final goods and services produced within a country in a given period of time.

- **Liquidity –** relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **Monetary Policy Committee (MPC) –** The MPC is a committee of the Bank of England who meet each month to set the official bank base rate.

- **PWLB –** the Public Works Loan Board is a statutory board that is run within the UK Debt Management Office (DMO), it's function is to lend money to Local Authorities and other prescribed bodies.