Appendix 1

Treasury Management Half Yearly Report - 2015/16

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 Scrutiny 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 to 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 2015/16 financial year to 30 September 2015
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2015/16

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

United Kingdom (UK) economic performance to date and outlook

UK gross domestic product growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any Group of 7 (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% though there was a rebound in quarter 2 to +0.7%.

Growth was expected to weaken marginally 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. However, the purchasing manager's index for services issued on 5 October would indicate an even lower growth rate of around +0.3%, which would be a three year low.

Despite these headwinds, the Bank of England August Inflation Report 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 consumer price index (CPI) inflation has fallen to, or near to, zero over the last quarter.

Investment expenditure is also expected to support growth. Since then, worldwide economic statistics and UK consumer and business confidence have distinctly weakened so it would not be a surprise if the next Inflation Report in November were to cut those forecasts.

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.

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 United States 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.

<u>Sector Interest Rate Forecast (as at 1st October 2015)</u>

Dec 2015	Mar 2016	Jun 2016	Sep 2016	Dec 2016	Mar 2017	Jun 2017	Sep 2017	Dec 2017	Mar 2018	June 2018
0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%

Sector undertook its last review of interest rate forecasts on 11th August shortly after the quarterly Bank of England Inflation Report. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Full Council on 25 February 2015. 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 2015/16 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 in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 25 February 2015 is still fit for purpose in the current economic climate.

5. Investment Portfolio 2015/16

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. The continuing potential for a re-emergence of a 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 £10.3m of investments as at 30 September 2015 (£8.8m at 31 March 2015). Funds available for investment purposes can vary between £7m 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 0.60% against a target of 0.50%. The Council's budgeted investment return for 2015/16 is £25,000 (£12,500 for first 2 quarters). As at the end of the first 2 quarters of 2015/16 £35,330 of interest has been earned.

Interest earned is in excess of the amount budgeted due to:

- The average interest rate yield being in excess of that expected, and;
- Amounts held for investment being in excess of those forecasted (due to asset sales and the profiled expenditure of the Councils capital programme).

A full list of investments held as at 30 September 2015 is shown in Annex A.

6. Borrowing Position 2015/16

It is not currently intended to borrow to finance capital investment in 2015/16. The only borrowing envisaged by the 2015/16 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 2015/16

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2015/16 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 30/09/15			
ACK NO.	**BROKER**	**INT. RATE**	**DATE INVESTED**	**NAME OF BORROWER**	**PRINCIPAL (£)**	**DATE MATURING**
5228	Direct	1.00%	3/12/2014	HALIFAX BANK OF SCOTLAND	2,000,000	2/12/2015
5238	Direct	0.63%	9/4/2015	BARCLAYS BANK	2,000,000	9/10/2015
5239	LCB	0.66%	1/5/2015	NATIONWIDE BUILDING SOCIETY	1,000,000	2/11/2015
5241	RPM	0.66%	3/6/2015	NATIONWIDE BUILDING SOCIETY	2,800,000	3/12/2015
5242	RPM	0.60%	3/6/2015	COVENTRY BUILDING SOCIETY	1,000,000	3/12/2015
					8,800,000	
		0.90%		SANTANDER 95 DAY NOTICE ACCOUNT	1,500,000	
				TOTAL INVESTMENTS	**10,300,000**	
				HERITABLE BANK INVESTMENT		
5092	TRAD	6.10%	15/09/2008	**HERITABLE BANK *(Landsbanki)***	50,184	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 and £99,932 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 and 27th August 2015 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.

- **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.

- **G7** – The Group of 7 (G7) is a group consisting of the finance ministers and central bank governors of seven major advanced economies, as reported by the International Monetary Fund, which meet to discuss primarily economic issues (Canada, France, Germany, Italy, Japan, United Kingdom, United States).

- **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.