Appendix 1

Treasury Management Half Yearly Report – 2016/17

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. However, as identified at the meeting of the Council that took place on 7 September 2016, due to the delay in capital receipts prudential borrowing will most likely be required towards the end of the 20161/7 financial year.

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 2016/17 financial year to 30 September 2016
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2016/17

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

<u>United Kingdom (UK) economic performance to date and outlook</u>

UK Gross Domestic Product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of sterling against the Euro, and weak growth in the European Union (EU), China and emerging markets, plus the dampening effect of the Government's continuing austerity programme.

The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on 4 August 2016 addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on 23 November 2016.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. Consumer Price Index (CPI) has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the Monetary Policy Committee (MPC) is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

Sector Interest Rate Forecast (as at 1st October 2016)

Dec 2016	Mar 2017	Jun 2017	Sep 2017	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	June 2019
0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%

Sector undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4 August 2016 cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. The Governor of the Bank of England has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by Full Council on 24 February 2016. 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 UK financial institutions.

Investments during the first six months of the 2016/17 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 24 February 2016 is still fit for purpose in the current economic climate.

5. Investment Portfolio 2016/17

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 0.25% 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 £9.5m of investments as at 30 September 2016 (£7.5m at 31 March 2016). Funds available for investment purposes can vary between £7.5m and £12.5m 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 0.68% against a target of 0.85%. The Council's budgeted investment return for 2016/17 is £83,000 (£41,500 for first 2 quarters). As at the end of the first 2 quarters of 2016/17 £43,000 of interest has been earned. Since the figure of 0.85% was estimated for the Medium Term Financial Strategy, the base rate has been significantly reduced by the Bank of England. However due to additional funds currently being available for investment it has been possible to bridge the gap against the budget.

A full list of investments held as at 30 September 2016 is shown in Annex A.

6. Borrowing Position 2016/17

The only borrowing envisaged by the 2016/17 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.

However, as resolved at the meeting of the Council that took place on 7 September 2016, due to the delay in capital receipts, prudential borrowing will most likely be required towards the end of the 2016/17 financial year.

7. Prudential Indicators 2016/17

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicat
ors contained in the approved 2016/17 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 30/09/16		
ACK NO.	**BROKER**	**INT. RATE**	**DATE INVESTED**	**NAME OF BORROWER**	**PRINCIPAL (£)**	**DATE MATURING**
5243	LCB	0.71%	03/05/2016	NATIONWIDE BUILDING SOCIETY	1,000,000	03/11/2016
5245	LCB	0.71%	06/06/2016	NATIONWIDE BUILDING SOCIETY	1,000,000	06/12/2016
5250	LCB	0.29%	10/08/2016	NATIONWIDE BUILDING SOCIETY	1,000,000	10/11/2016
					3,000,000	
		0.65%		SANTANDER 95 DAY NOTICE ACCOUNT	3,500,000	
		0.90%		SANTANDER 180 DAY NOTICE ACCOUNT	3,000,000	
				TOTAL INVESTMENTS	**9,500,000**	
				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 30 July 2009, 18 December 2009, 30 March 2010, 16 July 2010, 18 October 2010, 14 January 2011, 19 April 2011, 15 July 2011, 20 October 2011, 23 January 2012, 20 April 2012, 20 July 2012, 17 January 2013, 23 August 2013 and 27 August 2015 respectively.

The bank's administrators have confirmed the execution of a settled de-minimis payment from the parent company of Heritable Bank which will be paid to the Council in the event that the remaining 2% of the original investment is no longer contingent.

The de-minimis payment would be the equivalent amount EUR 11,913.10, which as at 8 February 2016 (the date of the published selling rate of the EUR as registered by the Central Bank of Iceland) equates to £9,411.35.

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** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index 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.

- **GDP** – Gross Domestic Product 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.

- **MPC** – interest rates are set by the Bank of England’s Monetary Policy Committee. The MPC sets an interest rate it judges will enable the inflation target to be met