COUNCIL

TUESDAY, 15TH DECEMBER 2015

REPORT OF THE PORTFOLIO HOLDER FOR OPERATIONS AND ASSETS

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW REPORT 2015/16

EXEMPT INFORMATION

None

PURPOSE

To present to Members the Mid-year review of the Treasury Management Strategy Statement and Annual Investment Strategy.

RECOMMENDATIONS

That Council:

1. **Accept the Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2015/16;**

2. **Approve the changes to the credit methodology whereby viability, financial strength and support ratings will not be considered as key criteria in the choice of creditworthy investment counterparties, and revise the minimum sovereign credit criterion to AA- for all sovereigns within our current Annual Investment Strategy; and**

3. **Approve the inclusion of Property Funds within the Treasury Management Strategy Statement and Annual Investment Strategy as an additional form of Non- Specified Investment for potential future use.**

EXECUTIVE SUMMARY

This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following

- An economic update for the first six months of 2015/16;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's Capital Position (Prudential Indicators);
- A review of the Council's investment portfolio for 2015/16;
- A review of the Council's borrowing strategy for 2015/16;
- A review of any debt rescheduling undertaken during 2015/16;
- Icelandic Banking Situation;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

The main issues for Members to note are:

1. The Council has complied with the professional codes, statutes and guidance.

2. There are no issues to report regarding non-compliance with the approved prudential indicators.

3. The investment portfolio yield for the first six months of the year is 0.69% (0.56% for the same period in 2014/15) compared to the 3 Month LIBID benchmark rate of 0.46% (0.42% for the same period in 2014/15). This excludes all investments currently classified as ‘At Risk’ in the former Icelandic Banking institutions.

4. In keeping with recent changes in the Credit Rating Agencies’ methodologies, in response to the evolving regulatory regime, the credit element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used by Standard & Poor’s, this has been a change to the use of Fitch and Moody’s ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed. Our Treasury management consultants Capita have recommended that in order to be consistent with the above approach and to allow us to fully access the revised list of banking counterparties under the new methodology, that we should amend our current Annual Investment Strategy minimum sovereign credit criterion to AA- for all sovereigns.

5. Following a review of other investment options that are not currently included within our 2015/16 Strategy Statement, Members are requested to approve the inclusion of Property Funds as an addition to the list of non- specified investments for potential future use.

The aim of this report is to inform Members of the treasury and investment management issues to enable all Members to have ownership and understanding when making decisions on Treasury Management matters. In order to facilitate this, training on Treasury Management issues has been delivered for Members in February 2015 and October 2015.

RESOURCE IMPLICATIONS

All financial resource implications are detailed in the body of this report which links to the Council’s Medium Term Financial Strategy.

LEGAL/RISK IMPLICATIONS BACKGROUND

Risk is inherent in Treasury Management and as such a risk based approach has been adopted throughout the report with regard to Treasury Management processes.

SUSTAINABILITY IMPLICATIONS

None

BACKGROUND INFORMATION

The Chartered Institute of Public Finance and Accountancy (CIPFA) issued its revised Code of Practice for Treasury Management in November 2009 (revised 2011) following consultation with Local Authorities during that summer. The revised Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This is the second monitoring report for 2015/16 presented to Members this year and therefore ensures this Council is embracing Best Practice in accordance with CIPFA's revised Code of Practice. Cabinet also receive regular monitoring reports as part of the quarterly healthcheck on Treasury Management activities and risks.

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 liquidity initially before considering maximising investment return.

The second main function of the Treasury Management service is the funding of the Council'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 occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

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*."

Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011) was adopted by this Council on 13th December 2012.

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, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
4. 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.
5. 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 Audit and Governance Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2015/16;
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- A review of the Council's investment portfolio for 2015/16;
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- A review of any debt rescheduling undertaken during 2015/16;
- Icelandic Banking Situation;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

Key Changes to the Treasury and Capital Strategies.

1. Changes in credit rating methodology.

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the credit element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used by Standard & Poor's, this has been a change to the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, authorities typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution, merely a reassessment of their methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support.

In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

Our Treasury management consultants Capita have also recommended that in order to be consistent with the above approach, and to allow us to fully access the revised list of banking counterparties under the new methodology, that we should amend our current Annual Investment Strategy minimum sovereign credit criterion to AA- for all sovereigns.

2. Property Funds

Following a review of other investment options that are not currently included within our 2015/16 Strategy Statement, Members are requested to approve the inclusion of Property Funds as an addition to the list of non- specified investments for potential future use.
The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Limits will be set based on levels of reserves and balances going forward and appropriate due diligence will be undertaken before investment of this type is considered.

3. Economic Update

3.1.1 UK

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% though there was a rebound in quarter 2 to +0.7%. The Bank of England's August Inflation Report included a forecast for growth to remain around 2.4 – 2.8% over the next three years. However, the subsequent forward looking Purchasing Manager's Index, (PMI), surveys in both September and early October for the services and manufacturing sectors showed a marked slowdown in the likely future overall rate of GDP growth to about +0.3% in quarter 4 from +0.5% in quarter 3. This is not too surprising given the appreciation of Sterling against the Euro and weak growth in the EU, China and emerging markets creating headwinds for UK exporters. Also, falls in business and consumer confidence in September, due to an increase in concerns for the economic outlook, could also contribute to a dampening of growth through weakening investment and consumer expenditure. For this recovery to become more balanced and sustainable in the longer term, the recovery still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly over the last few years although it has now ticked up recently after the Chancellor announced in July significant increases planned in the minimum (living) wage over the course of this Parliament.

The MPC has been particularly concerned that the 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. It has therefore been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which slipped back to zero in June and again in August 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. The August Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon.

Despite average weekly earnings ticking up to 2.9% y/y in the three months ending in July, (as announced in mid-September), this was unlikely to provide ammunition for the MPC to take action to raise Bank Rate soon as labour productivity growth meant that net labour unit costs appeared to be only rising by about 1% y/y.

However, at the start of October, statistics came out that annual labour cost growth had actually jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

There are therefore considerable risks around whether inflation will rise in the near future as strongly and as quickly as previously expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as had previously been expected, 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. On the other hand, there are also concerns around the fact that the central banks of the UK and US have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are therefore arguments that they need to raise rates sooner, rather than later, so as to have ammunition to use if there was a sudden second major financial crisis. But it is hardly likely that they would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has therefore progressively been pushed back during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much 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 Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

3.1.2 U.S.

GDP growth in 2014 of 2.4% was followed by first quarter 2015 growth depressed by exceptionally bad winter weather at only +0.6% (annualised). However, growth rebounded very strongly in Q2 to 3.9% (annualised) and strong growth was initially expected going forward. Until the turmoil in financial markets in August caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed might start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, and due to a 20% appreciation of the dollar which has caused the Fed to lower its growth forecasts. Since then the nonfarm payrolls figures for September and revised August, issued on 2 October, were disappointingly weak and confirmed concerns that US growth is likely to significantly weaken. This has pushed back expectations of the first rate increase from 2015 into 2016.

3.1.3 Eurozone

The ECB fired its big bazooka by announcing a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme started in March and will run to September 2016. This seems to have already had a beneficial impact in improving confidence and sentiment. There has also been a continuing trend of marginal increases in the GDP growth rate which hit 0.4% in quarter 1 2015 (1.0% y/y) and +0.4%, (1.5% y/y) in Q2 GDP. The ECB has also stated it would extend its QE programme if inflation failed to return to its target of 2% within this initial time period.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands.
An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

3.1.4 China and Japan

Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth. In Q2 2015 growth was -1.6% (annualised) after a short burst of strong growth of 4.5% in Q1. During 2015, Japan has been hit hard by the downturn in China. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, but has dithered about firing the third, deregulation of protected and inefficient areas of the economy, due to political lobbies which have traditionally been supporters of Abe's party.

As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market. Many commentators are concerned that recent growth figures around that figure, could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much bank lending to corporates and local government during the post 2008 credit expansion period and whether the bursting of a bubble in housing prices is drawing nearer. Overall, China is still expected to achieve a growth figure that the EU would be envious of. However, concerns about whether the Chinese cooling of the economy could be heading for a hard landing, and the volatility of the Chinese stock market, have caused major volatility in financial markets in August and September such that confidence is, at best, fragile.

3.1.5 Emerging Countries

There are considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in western currency denominated debt since the financial crisis, caused by western investors searching for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields (due to QE), and near zero interest rates, into emerging countries, there is now a strong current flowing to reverse that flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields. This change in investors' strategy and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US and UK, has helped to cause the dollar and sterling to appreciate. In turn, this has made it much more costly for emerging countries to service their western currency denominated debt at a time when their earnings from commodities are depressed.

There are also going to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates, if available at all.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by sovereign wealth funds of countries highly exposed to falls in commodity prices which, therefore, may have to liquidate investments in order to cover national budget deficits.

3.2 Interest rate forecasts

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	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%

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.

The disappointing US nonfarm payrolls figures and UK PMI services figures at the beginning of October have served to reinforce a trend of increasing concerns that growth is likely to be significantly weaker than had previously been expected. This, therefore, has markedly increased concerns, both in the US and UK, that growth is only being achieved by monetary policy being highly aggressive with central rates at near zero and huge QE in place. In turn, this is also causing an increasing debate as to how realistic it will be for central banks to start on reversing such aggressive monetary policy until such time as strong growth rates are more firmly established and confidence increases that inflation is going to get back to around 2% within a 2-3 year time horizon. Market expectations in October for the first Bank Rate increase have therefore shifted back sharply into the second half of 2016.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.
- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Council on 24th February 2015.

In the Annual Report on the Treasury Management Service and Actual Prudential Indicators 2014/15 reported to Council on the 15th September 2015, Members approved a request for increases in existing Counter Party lending limits for 2015/16.

In keeping with recent changes in the Credit Rating Agencies' methodologies, in response to the evolving regulatory regime, the credit element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used by Standard & Poor's, this has been a change to the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

Our Treasury management consultants Capita have also recommended that in order to be consistent with the above approach, and to allow us to fully access the revised list of banking counterparties under the new methodology, that we should amend our current Annual Investment Strategy minimum sovereign credit criterion to AA- for all sovereigns

Following a review of other investment options that are not currently included within our 2015/16 approved Strategy Statement, Members are asked to approve the inclusion of Property Funds as an addition to the list of non- specified investments for potential future use. The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Limits will be set based on levels of reserves and balances going forward and appropriate due diligence will also be undertaken before investment of this type is considered.

The details in this report also update the position in the light of the updated economic position and budgetary changes already approved.

5. The Council's Capital Position (Prudential Indicators)

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 the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	2015/16 Original Programme	Budget B'fwd from 2014/15	Virements to Programme in Year	Total 2015/16 Budget	Actual Spend @ Period 6	2015/16 Revised Estimate*
	£m	£m	£m	£m	£m	£m
General Fund	1.901	1.651	-	3.552	0.347	3.552
HRA	10.430	2.302	-	12.732	3.353	12.692
Total	**12.331**	**3.952**	**-**	**16.283**	**3.700**	**16.244**

* including potential expenditure slippage into 2016/17

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	**2015/16 Estimate £m**	**2015/16 Revised Estimate * £m**
Unsupported	1.000	1.000
Supported	15.283	15.244
Total spend	**16.283**	**16.244**
Financed by:		
Grants - Disabled Facilities	0.224	0.224
Coalfields Grant	0.252	0.252
Section 106's	0.459	0.459
GF Receipts	0.232	0.232
GF Reserve	0.488	0.488
HRA Receipts	0.441	0.441
HLF Assembly Rooms Lottery	0.200	0.200
Lottery Grant BMX Track	0.007	0.007
HLF/SCC/Donation - Castle Mercian Trail	0.250	0.250
MRR	4.616	4.616
HRA 1-4-1 Replacements Receipts	0.851	0.851
HRA Reserve	3.986	3.966
HRA Regeneration Fund	3.277	3.258
Total Financing	**15.283**	**15.244**
Borrowing need	**1.000**	**1.000**

* including potential expenditure slippage into 2016/17

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table 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.

5.3.1Prudential Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement.

5.3.2 Prudential Indicator – External Debt / the Operational Boundary

External Debt / Operating Boundary	2014/15 Outturn £m	2015/16 Original Estimate £m	2015/16 Revised Estimate £m
CFR – Non Housing	1.241	1.973	1.700 *
CFR – Housing	68.042	68.017	68.041
Total CFR	69.283	69.990	69.741
Net movement in CFR	**(0.070)**	**0.719**	**0.458**
Operational Boundary			
Expected Borrowing	72.268	73.268	72.268
Other long term liabilities	-	-	-
Total debt 31 March	**72.268**	**73.268**	**72.268**

* Reduced by additional Voluntary Repayment of principal in relation to the capitalisation value of outstanding Icelandic debt.

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and 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.

Net Borrowing / Capital Financing Requirement	2014/15 Outturn £m	2015/16 Original Estimate £m	2015/16 Revised Estimate £m
Gross borrowing	65.060	66.060	66.060
Plus other long term liabilities	-	-	-
Less investments	32.353	21.092	25.000
Net borrowing	32.707	44.968	41.060
CFR (year end position)	69.283	69.990	69.741

The Executive Director Corporate Services reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

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 of 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	2015/16 Original Indicator	Current Possition	2015/16 Revised Indicator
Borrowing	89.112	89.112	89.112
Other Long Term Liabilities	3.000	3.000	3.000
Total	92.112	92.112	92.112

6. 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 £39.62m of investments as at 30th September 2015 (£31.70m at 31st March 2015) and the investment portfolio yield for the first six months of the year is 0.69% against a benchmark of the 3 months LIBID of 0.46%. A full list of investments held as at 30th September 2015 is detailed in **APPENDIX 1**.

The Executive Director Corporate Services confirms that on one occasion during the first six months of 2015/16 that the approved limits within the Annual Investment Strategy were breached. This occurred when an outward going CHAPS payment in respect of a deposit was not actioned by an agreed deadline, resulting in £2.6m being held within the Lloyds Bank account overnight, which exceeded the approved limit of £1m.

The Council's budgeted investment return for 2015/16 is £317k, and performance for the year is projected to be £57k above budget.

CIPFA Benchmarking Club

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance over the year against other members.
Our average return for In House Investments for the period October 2014 to September 2015 was 0.62% compared to the group average of 0.83% (information from CIPFA Benchmarking Draft Report Q2 2015/16) excluding the impaired investments in Icelandic banks. This is considered to be a reasonable result in light of the current financial climate,

our lower levels of deposits/funds and shorter investment time-lines due to Banking sector uncertainty, when compared to other Authorities.

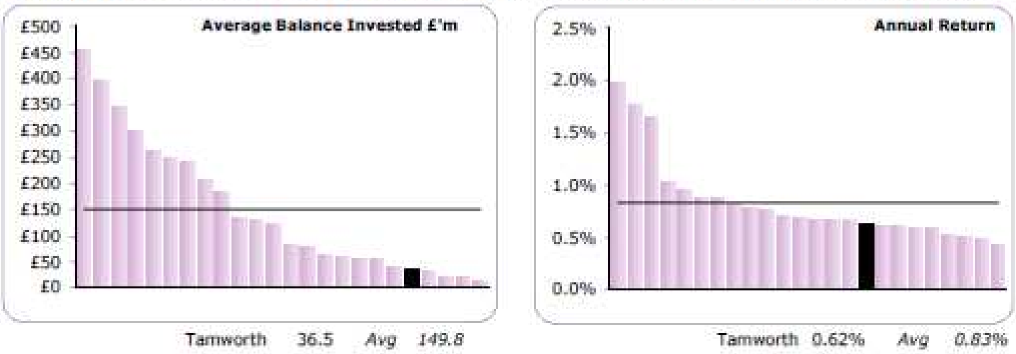
This can be analysed further into the following categories:

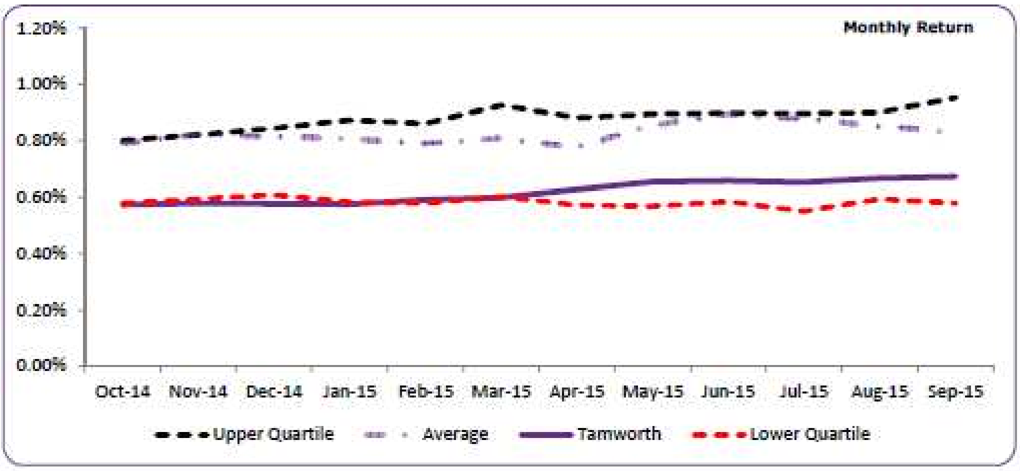
	Average Balance Invested £m		Average Annual Return Received %	
Category	Tamworth Borough Council	CIPFA Benchmarking Club	Tamworth Borough Council	CIPFA Benchmarking Club
Fixed Investments (up to 30 days)	-	0.7	0.41	0.43
Fixed Investments (between 31 and 90 days)	0.5	2.1	0.44	0.46
Fixed Investments (between 91 and 364 days)	21.0	57.5	0.71	0.74
Fixed Investments (between 1 year and 5 years)	1.0	18.9	1.00	1.68
Callable and Structured Deposits	-	33.1	-	2.35
Notice Accounts	1.2	24.7	0.46	0.56
Money Market Funds (Constant Net Asset Value)	10.0	200.1	0.40	0.45
Money Market Funds (Variable Net Asset Value)	-	17.8	-	1.13
DMADF	-	2.6	-	0.25
CD's, Gilts and Bonds	2.7	23.1	0.73	1.19
Average of all investments (Managed in House)	**36.5**	**290.3**	**0.62**	**0.83**

The data above and graphs below display that despite the Council being a small investor in the markets, performance is only marginally lower in those areas where both the Council and other member authorities invest.

The main variances arise from instruments that the council do not currently get involved with i.e. Callable and Structured Deposits which are longer term deposits which (in line with our use of the Capita Asset Services methodology and our approved specified limits in our Treasury Management strategy) are currently prohibited for Tamworth Borough Council and affirms our ‘low appetite for risk’ in the continuing unsettled markets.

COMBINED IN-HOUSE INVESTMENTS (excluding impaired investments)





Monthly Return (Oct 14 - Sep 15)	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Year
Av Bal £'m	34.17	33.45	34.36	34.78	33.50	33.09	35.71	36.57	38.77	40.07	41.06	41.90	36.47
Earned £'k	16.6	15.9	16.8	17.0	15.2	16.8	18.4	20.3	21.0	22.2	23.3	23.2	226.7
Upper Quartile	0.80%	0.82%	0.84%	0.87%	0.86%	0.93%	0.88%	0.90%	0.90%	0.90%	0.90%	0.95%	0.87%
Average	*0.79%*	*0.82%*	*0.81%*	*0.81%*	*0.79%*	*0.81%*	*0.78%*	*0.85%*	*0.89%*	*0.88%*	*0.85%*	*0.83%*	*0.83%*
% Return	0.57%	0.58%	0.58%	0.57%	0.59%	0.60%	0.63%	0.65%	0.66%	0.65%	0.67%	0.67%	0.62%
Lower Quartile	0.58%	0.59%	0.61%	0.58%	0.58%	0.60%	0.57%	0.57%	0.58%	0.55%	0.59%	0.58%	0.60%
% Diff from Av	-0.22%	-0.24%	-0.24%	-0.23%	-0.20%	-0.21%	-0.15%	-0.20%	-0.24%	-0.23%	-0.18%	-0.15%	

Investment Counterparty Criteria

The current investment counterparty criteria selection approved in the TMSS and as amended at Council on the 15th September 2015, together with approval of recommendations contained within this report, will meet the requirement of the Treasury Management function.

7. Borrowing

The Council's estimated revised capital financing requirement (CFR) for 2015/16 is £69.741m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 5.4 shows the Council will have estimated borrowings of £66.060m and has utilised £3.681m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

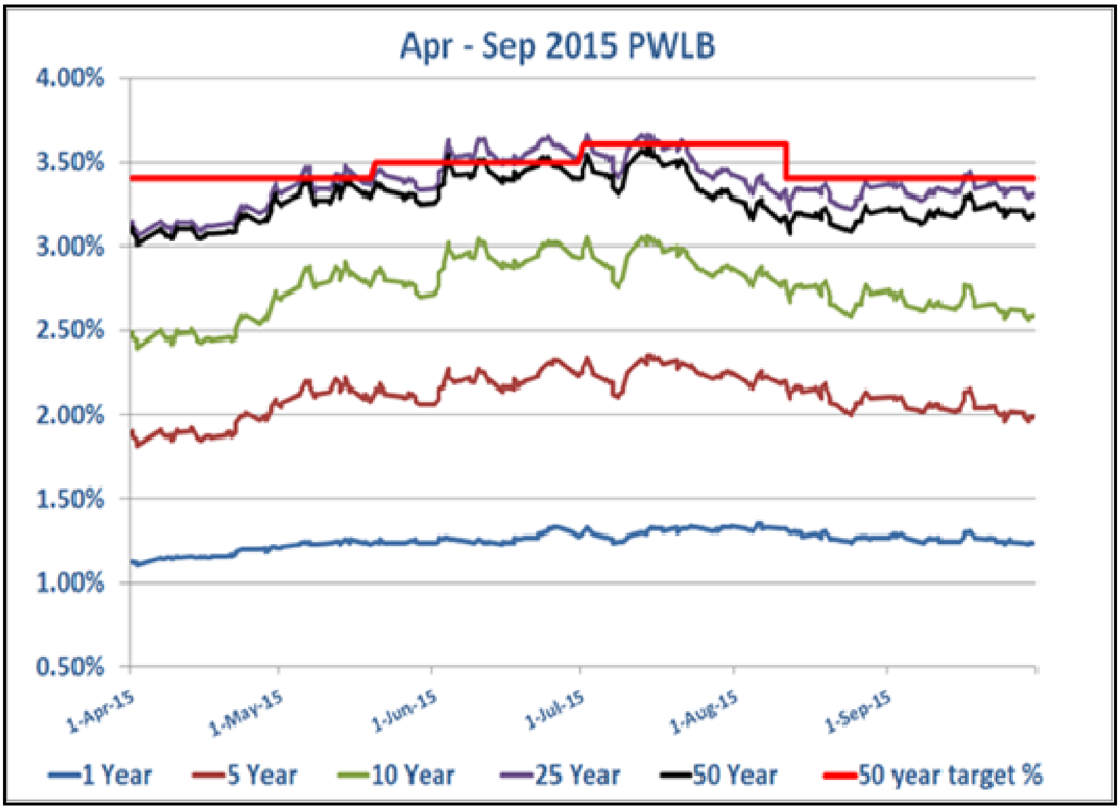
In the first half of the year the Council had PWLB debt of £1m maturing, with a further £2m maturing in October 2015. Due to the current volatility in interest rates payable to replace these loans, the Treasury Management team have set a target rate for replacement and are monitoring the opportunities to replace these loans when appropriate. It is anticipated that a rate of around 3.2% will be achievable for a 50 year period. This compares to rates of 11.625% and 5.125% respectively, which was being paid on the maturing loans.

As outlined below, the general trend has been an increase in interest rates during the first quarter but then a fall during the second quarter.

It is anticipated that further additional borrowing of £1m may be undertaken during this financial year, in line with the current Capital programme.

The table and graph below show the movement in PWLB (Certainty Rates) for the first six months of the year to 30.9.15:

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/2015	02/04/2015	02/04/2015	02/04/2015	02/04/2015
High	1.35%	2.35%	3.06%	3.66%	3.58%
Date	05/08/2015	14/07/2015	14/07/2015	02/07/2015	14/07/2015
Average	1.26%	2.12%	2.76%	3.39%	3.29%



8. Debt Rescheduling

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 2015/16.

9. Icelandic Banks Update

Appendix 2 contains details of the situation with Icelandic investments as at 30th September 2015.
Expectations of future receipts and timeframes based on current information regarding each bank are given below;

- Glitnir

On 15th March 2012, the Council received £2.554m being the majority of our deposits with the bank. The balance of our approved claim, equating to £587k, is being held in an interest bearing ESCROW account. The release of these funds is dependent on a change in Icelandic Law which currently does not allow the distribution of ISK outside the country. Interest will accrue on these funds until the date of final settlement, which is still unknown.

- Heritable

As at the end of September the Council had received £1.475m against our claim of £1.505m, a total recovery of 98%. Negotiations are currently underway to finalise the affairs of Heritable and it is anticipated that a distribution of residual funds will be made over the next few months.

- Kaupthing, Singer and Friedlander

As at the end of September the Council had received £2.620m against our claim of £3.175m. Current estimates given by the Administrator project a total recovery of 85.25% or approximately £2.707m, with the majority of repayments estimated to be received by June 2016.

REPORT AUTHOR

Please contact Phil Thomas Financial Accountant extension 239

LIST OF BACKGROUND PAPERS

Background Papers -	*Local Government Act 2003*
	CIPFA Code of Practice on Treasury Management in Public Services 2011
	Annual Report on the Treasury Management Service and Actual Prudential Indicators 2014/15 –Council 15th September 2015
	Treasury Management Strategy & Prudential Indicators Report 2015/16 - Council 24th February 2015
	Budget & Medium Term Financial Strategy 2015/16 - Council 24th February 2015
	Financial Healthcheck Period 6, September 2015
	CIPFA Treasury Management Benchmarking Club Report Quarter 2, September 2015

APPENDICES

APPENDIX 1 Current Investment List
APPENDIX 2 Icelandic Banking Situation