TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

22 June 2015

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Cabinet - Council Decision

1 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2014/15

This report provides details of treasury management activity undertaken during April and May of the current financial year. The treasury management outturn position for 2014/15 is due to be reported to the June meeting of Cabinet and is also included in this report. Members are invited to endorse the action taken in respect of treasury management activity to the end of May 2015 and note the outturn position for 2014/15.

1.1 Introduction

1.1.1 The Chartered Institute for Public Finance and Accountancy (CIPFA) issued a revised Code of Practice for Treasury Management in November 2009. The revised Code was adopted by the Council on 18 February 2010 and suggests that Members should be informed of treasury management activities at least twice a year, but preferably quarterly. This report, therefore, ensures this Council is embracing best practice in accordance with CIPFA's revised Code of Practice and subsequent updates.

1.2 Economic Background

1.2.1 Thus far in 2014/15:

- The May Inflation Report saw the Bank of England reduce its forecasts for annual growth from 2.9% to 2.5% in 2015 and 2.7% in 2016. 2017 growth was forecast at 2.4% down from 2.7%. There were a number of contributing factors to these downward revisions.

- UK growth in quarter 1 2015 was disappointing and slowed to 0.3% (2.4% y/y) from 0.6% (3.0% y/y) in the previous quarter.

- The Bank also took a more pessimistic view on the rate and timing of growth in labour productivity and of increases in wages. The Bank cut its forecast for wages growth in 2015 from 3.5% to 2.5%. This is despite strong growth in employment and continuing reductions in the rate of unemployment which has now fallen to 5.5%. Despite the positive news, wages (excluding bonuses) increased by only 1.9% per annum over the last three months. In the longer term a sustainable recovery is dependent on productivity improving allowing wages to rise faster than the rate of inflation.

- CPI inflation fell to -0.1% in April. This dip into deflation will only last for a short period until the fall in oil and food prices drop out of the twelve month calculation. CPI is expected to rise especially during Q4 2015 and be marginally higher than target (2%) two years from now.

- The Greek government, led by an anti-austerity party Syriza, is making a strong push to renegotiate the country's debt repayments. This has been met with a robust rejection by the European Central Bank (ECB), European Union and International Monetary Fund. There is a risk that this could end with Greece leaving the Euro. However, the Eurozone (EZ) has put in place sufficient firewalls that a Greek exit would have little direct impact on the rest of the EZ and the Euro.

- The American economy experienced disappointing growth in Q1 2015. GDP grew by 0.2% on an annualised basis due to bad weather hitting construction and consumer spending, a ports strike and the near 20% appreciation in the value of the dollar. However, growth is expected to recover strongly in quarter 2 and resume the trend to full recovery from the financial crash. Annualised growth for 2014 Q2, Q3 and Q4 of 4.6%, 5.0% and 2.6% hold promise for strong growth going forward and for further falls in unemployment. The Federal Reserve is expected to start increasing interest rates during 2015 and is likely to be the first major western central bank to do so.

- The ECB announced a €1.1 trillion programme of quantitative easing in January 2015. The programme which started in March and will run to September 2016 has already had a beneficial impact in improving confidence and sentiment in the EZ. The recent trend of marginal increases in GDP has continued with GDP of 0.4% in quarter 1 2015 (1.0% y/y). Deflation has also ended with inflation standing at 0.0% in April.

1.3 Interest Rate Forecast

1.3.1 The Bank Rate has remained at an emergency level of 0.5% for the last 6 years. Capita's latest forecast, updated May 2015, anticipates the Bank Rate will remain at this level for a further 12 months before rising in the second quarter of 2016. Six months later than anticipated in the 2015/16 Annual Investment Strategy.

Rate	Now %	Jun-15 %	Sep-15 %	Dec-15 %	Mar-16 %	Jun-16 %	Sep-16 %	Dec-16 %	Mar-17 %	Jun-17 %	Sep-17 %	Dec-17 %
Bank Rate	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.50	1.50
3 mth LIBID	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.10	1.30	1.40	1.50	1.80
6 mth LIBID	0.66	0.70	0.70	0.80	0.90	1.00	1.10	1.30	1.50	1.60	1.70	2.00
12 mthLIBID	0.99	1.00	1.00	1.10	1.20	1.30	1.40	1.60	1.80	1.90	2.00	2.30
25yr PWLB	3.40	3.50	3.60	3.70	3.80	4.00	4.10	4.20	4.30	4.40	4.40	4.50

1.4 2015/16 Treasury Management Performance

1.4.1 The Annual Investment Strategy for the 2015/16 financial year was approved by Council on 17 February 2015. The Strategy, outlines the Council's investment priorities as follows:

- Security of Capital,
- Liquidity.

1.4.2 In addition the Council aims to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In particular, for 2015/16 the Council will "avoid locking into longer term deals while investment rates continue their current low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile". The Council has adopted Capita's recommended creditworthiness approach which incorporates the credit ratings from each of the three main rating agencies and includes sovereign credit ratings and a market view of risk using credit default swap (CDS) data.

1.4.3 A full list of investments held on 31 May 2015 and our internal lending list in operation on that date are shown in **[Annexes 1 and 2]** of this report.

1.4.4 As illustrated above, investment rates available in the market are at an historical low point. The average level of cash flow funds available for investment purposes to the end of May 2015 was £9.3m. These funds were available on a temporary basis and the amount mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The Authority holds £13.4m of core cash balances. These funds are for the most part available to invest for more than one year, albeit some funds will need to be recalled towards the end of the financial year to top-up our daily cash balances.

1.4.5 As at the end of May 2015 funds invested and interest earned is set out in the table below:

	Funds invested at 31 May 2015 £m	**Average duration to maturity Yrs**	**Weighted average rate of return %**	**Interest earned to 31 May 2015 £**	**Gross annualised return to 31 May 2015 %**	**7 day LIBID benchmark %**
Cash flow	9.3	0.35	0.74	11,850	0.63	0.36
Core funds	13.4	0.38	0.81	17,750	0.79	0.36
Total	22.7	0.37	0.78	29,600	0.71	0.36

1.4.6 Interest earned of £29,600 is some £1,600 better than budget and 35 basis points better than benchmark.

1.4.7 **Cash Flow**. Our daily cash flow balances for the year ahead are modelled at the start of the financial year. That cash flow model is then updated daily and reviewed on a regular basis. The majority of our cash flow surpluses are invested overnight in bank deposit accounts and money market funds to ensure sufficient short term liquidity to meet payment obligations. However, when cash surpluses permit, fixed term investments are undertaken to take advantage of the higher yields available. Thus far £5m nine month fixed term investments have been arranged yielding circa 0.8%.

1.4.8 The current cash flow forecast **[Annex 3]** points to more fixed term investment opportunities being available this summer. Duration will need to be limited to around six months to ensure these funds are available to support spending needs towards the end of the financial year (ends 31st March 2016).

1.4.9 **Core Funds**. Following the transfer of all core fund investments from our extremal fund manager to in-house management in August 2014, the opportunity to enhance yield by extending duration has continued. The current core fund portfolio includes a mix of nine and twelve month deposits together with one high yielding call account. The pattern of maturities is designed to ensure additional liquidity is available to the Council to support spending should the need arise and to take advantage of interest rate rises when they occur.

1.5 Benchmarking

1.5.1 The Council takes advantage of Capita's benchmarking facility which enables us to gauge our performance against Capita's other local authority clients. An extract from the latest benchmarking data is provided in the form of a scatter graph at **[Annex 4]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. As at 31 March 2015 our return at 0.75% (purple diamond) was above the average of 0.70% for all other local authorities and relative to the Council's exposure to credit / duration risk that return was at the top end of Capita's predicted return (just below the upper boundary indicated by the green diagonal line).

1.6 Compliance with 2015/16 Annual Investment Strategy

1.6.1 During the financial year to date the Council has operated within the treasury limits and prudential indicators set out in the Annual Investment Strategy. The Prudential and Treasury Indicators will be included for review as part of the treasury management report to the September 2015 meeting of Audit Committee. No borrowing was undertaken during April or May 2015.

1.6.2 Throughout April and May 2015 all of the requirements contained in the 2015/16 Annual Investment Strategy intended to limit the Council's exposure to investment risks (minimum sovereign and counterparty credit rating; durational limits;

exposure limits in respect of counterparties, groups of related counterparty and sovereigns; and specified and non-specified investment limits) have been complied with.

1.7 2014/15 Treasury Management Outturn

1.7.1 A detailed report covering treasury management activity for the last financial year is being submitted to Cabinet on 24 June 2015 as an annex to the Revenue and Capital Outturn report for 2014/15. That annex is replicated in full and provided at **[Annex 5]** to this report.

1.7.2 A summary of the investment performance included in **[Annex 5]** is as follows:

2014/15 Financial Year	**Average investment £m**	**Gross rate of return %**	**Interest earned £**	**Revised estimate £**
In-house managed cash flow	10.9	0.64	70,000	70,000
Externally managed core fund to 31 July	4.5	0.62	27,900	25,500
In-house managed core funds from 1 August	8.9	0.74	66,350	64,650
Total	24.3	0.68	164,250	160,150

1.7.3 The combined performance of the Authority's cash flow and core funds bettered the revised estimate by £4,100.

1.8 Legal Implications

1.8.1 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority including securing effective arrangements for treasury management. In addition, Capita are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.9 Financial and Value for Money Considerations

1.9.1 The Bank Rate has remained at a historical low (0.5%) for a sixth successive year. The Funding for Lending initiative introduced by the Bank of England in summer 2012 had a significant downward impact on returns being offered by financial institutions at the time and that impact has continued. At the end of May 2015, investment income of £29,600 has been earned exceeding the estimate for the same period by £1,600.

1.9.2 For the 2014/15 year as a whole the Council generated investment income of £164,250 which was £4,100 better than the 2014/15 revised estimate.

1.9.3 Performance is monitored against a benchmark return (7 Day LIBID) and against other local authorities in Kent and the broader local authority pool via Capita's benchmarking service.

1.10 Risk Assessment

1.10.1 The application of best practice, including the regular reporting and scrutiny of treasury management activity, as identified by the CIPFA Code is considered to be the most effective way of mitigating the risks associated with treasury management.

1.11 Equality Impact Assessment

1.11.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

1.12 Recommendations

1.12.1 Members are invited to **RECOMMEND** that Cabinet:

1) Endorse the action taken by officers in respect of treasury management activity for April and May 2015; and

2) Note the 2014/15 outturn position.

Background papers: contact: Mike Withey

Capita Interest Rate Forecast (May 2015)

Sharon Shelton
Director of Finance and Transformation