Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2016/17 and Quarterly Treasury Activity Report for Quarter ended 30 June 2016

Date: 4 August 2016

Author: Chief Financial Officer

Wards Affected

All

Purpose

To inform members of the performance monitoring of the 2016/17 Prudential Code Indicators, and to advise members of the quarterly treasury activity as required by the Treasury Management Strategy.

Key Decision

This is not a key decision.

Background

1.1 The Council is required by regulations issued under the Local Government Act 2003 to report on its Prudential Code indicators and treasury activity. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 For 2016/17 the minimum reporting requirements are that the Full Council should receive the following reports:

- An annual treasury strategy in advance of the year (the TMSS, considered by Cabinet on 18 February 2016 and subsequently approved by Full Council on 7 March 2016).
- A mid-year treasury update report
- An annual review following the end of the year describing the activity compared to the strategy.

In accordance with best practice, quarterly monitoring reports for treasury activity are provided to members, and this exceeds the minimum requirements.

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the position at 30 June 2016 and highlights compliance with the Council's policies.

Proposal

2.1 Economic update

UK GDP growth rates of 2.2% in 2013 and 2.9% in 2014 were the strongest of any G7 country. Growth in 2015 was a disappointing 1.8% but this remained one of the leading rates among the G7 countries. Growth improved in Q4 of 2015 from 0.4% to 0.7% but fell back again to 0.4% in Q1 of 2016. During most of 2015, the economy was challenging for exporters with the appreciation of sterling against the Euro, weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme and uncertainty created by the Brexit referendum. However, since the peak in November 2015, sterling has fallen significantly against the Euro which will help to make British goods and services more competitive, and will increase the value of overseas earnings by multinational companies based in the UK. The Chancellor has also announced that the target of achieving a budget surplus in 2020 will have to be eased in order to help the economy recover from the expected slowing of growth during the second half of 2016.

The Bank of England May Inflation Report included growth forecasts of 2.0% for 2016 and 2.3% for 2017 on the assumption that the referendum result was a vote to remain. The Governor of the Bank of England, Mark Carney, 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. In his 30 June and 1 July speeches, Mr Carney indicated that the Monetary Policy Committee (MPC), would be likely to cut Bank Rate and would consider further quantitative easing purchases of gilts, in order to support growth. However, he also warned that the Bank could not provide the entire economic stimulus required, and suggested that the Government would need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation).

The May 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. However, the falls in the price of oil and food twelve months ago will be falling out of the calculation of CPI during 2016 and in addition, the

recent fall in the value of sterling is likely to result in a 3% increase in CPI over a time period of 3-4 years. The pace of increase in inflation is therefore likely to accelerate, which could cause a dilemma for the MPC, which wants to help promote growth in the economy by keeping Bank Rate low.

The American economy experienced variable performance during 2015, overall growth of 2.4% including 0.6% in Q1, 3.9% in Q2, 2.0% in Q3 and 1.4% in Q4. Growth in Q1 of 2016 was 1.1% but forward indicators suggest an improvement during the rest of the year. The Federal Reserve (Fed) embarked on its long anticipated first increase in rates in December and at that point, confidence was high that there would then be four more increases during 2016. Since then, downbeat international news and the Brexit vote has caused a re-emergence of caution over the timing and pace of further increases. It is likely there will now be only one more increase in 2016.

In the Eurozone (EZ), the European Central Bank (ECB) commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This programme was initially intended to run to September 2016, but in response to continuing weak growth was extended to March 2017. This monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence, and has allowed some improvement in economic growth. GDP rose by 0.6% in Q1 of 2016 and is expected to continue growing, but at only a modest pace. The ECB is also struggling to get inflation up from near zero towards its target of 2%.

2.2 Interest rate forecasts

Capita Asset Services (CAS) undertook a quarterly review of its interest rate forecasts on 4 July 2016 after allowing markets to settle somewhat after the Brexit result of the referendum on 23 June. It is generally agreed that this outcome will result in growth slowing in the second half of 2016, at a time when the Bank of England has only limited opportunities to promote growth by using monetary policy. CAS expects that Bank Rate will be cut by 0.25%, probably in August, and could even be cut to 0% or 0.10%. No further action by the MPC on Bank Rate is anticipated during 2016 or 2017, since any recovery in growth is likely to be weak during a period of great uncertainty post-Brexit, however, the MPC may also consider renewing its programme of quantitative easing. CAS does not expect Bank Rate to start rising again until Q2 of 2018, and for further increases to then be at a slower pace than before. The Governor of the Bank of England has repeatedly stated that increases in Bank Rate will be slow and gradual when they do start, as 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 for some consumers, who have had no increases in pay, could be non-existent (other than through some falls in prices).

CAS have provided the following forecast:

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	1.00%	1.10%	1.10%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.30%	1.30%
10yr PWLB rate	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%	1.80%	1.80%	1.80%	1.90%
25yr PWLB rate	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%
50yr PWLB rate	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%

2.3 Investment strategy

The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by Council on 7 March 2016.

The Council's investment priorities remain the security of capital and good liquidity. Whilst the Council will always seek to obtain the optimum return (yield) on its investments, this will at all times be commensurate with proper levels of security and liquidity. In the current economic climate and with heightened credit concerns, it is considered appropriate either to keep investments short term to cover cash flow requirements, or to extend the period up to one year with selected government backed counterparties.

During the period from 1 April to 30 June 2016, significant use has been made of a Money Market Fund currently achieving a return of around 0.46%. This fund is an AAA rated investment vehicle which allows the pooling of many billions of pounds worth of funds into a highly diversified fund. Whilst the rate of return remains quite low, it is still well in excess of overnight treasury deposit rates.

The Treasury Activity Report for the quarter ended 30 June 2016 is attached at Appendix 1, in accordance with the Treasury Management Strategy. For reference, definitions of LIBOR and LIBID are given at Appendix 2.

Members will note that investment interest of £22,443 was generated during the period from 1 April to 30 June 2016. This represents an equated rate of 0.77% and outperforms the benchmark 7 day LIBID rate, which averaged

0.36% for the same period. In cash terms this represents additional income to the General Fund of around £12,000 and was achieved by positive investment management. Performance in respect of the longer 3 month LIBID rate, which averaged 0.46%, still represents additional income of £9,000.

Rates in the market remain very low and are expected to fall further by September 2016. As loans mature it is challenging to replace them, since security and liquidity will always be the overriding factors in the Council's treasury management. Interest rates are not expected to start rising again until at least Q2 of 2018, and then only gradually, and not significantly.

It is currently anticipated that the outturn for investment interest will be £77,800, a reduction of £17,800 on the original estimate for 2016/17 of £95,600, due to the projected fall in interest rates. The impact of this reduction is included in the Q1 revenue budget monitoring report elsewhere on this agenda.

Credit ratings advice continues to be taken from CAS and the Chief Financial Officer has adopted the CAS credit rating methodology for the selection of investment counterparties. This employs a sophisticated modelling approach utilising credit ratings from all three of the main rating agencies to give a suggested maximum duration for investments. Accordingly it does not give undue preponderance to one agency's ratings.

The methodology subsequently applies an "overlay" to take account of positive and negative credit watches and/or credit outlook information, which may increase or decrease the suggested duration of investments. It then applies a second overlay based on the credit default swap spreads for institutions, the monitoring of which has been shown to give an early warning of likely changes in credit ratings. It also incorporates sovereign ratings to ensure selection of counterparties from only the most creditworthy countries. The current treasury strategy permits the use of counterparties with a rating of AA- and better. Following recent downgrades, the UK currently has a rating of AA.

The CAS modelling approach combines all the various factors in a weighted scoring system and results in a series of colour coded bands which indicate the creditworthiness of counterparties. The colour bandings are as follows:

- Yellow 5 years (UK Government debt or its equivalent)
- Purple 2 years
- Blue 1 year (nationalised or semi nationalised UK banks only)
- Orange 1 year
- Red 6 months
- Green 100 days

- No colour not to be used

All credit ratings are monitored weekly and the Council is also alerted to interim changes via its use of the CAS creditworthiness service, however ratings under the methodology, including sovereign ratings, will not necessarily be the sole determinant of the quality of an institution. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The ultimate decision on what is prudent and manageable for the Council will be taken by the Chief Financial Officer under the approved scheme of delegation.

2.4 New borrowing

No new long-term borrowing was undertaken during the quarter ended 30 June 2016.

The Council's Capital Financing Requirement (CFR) represents its "underlying" need to borrow to finance capital investment. Due to favourable interest rates, borrowing in advance of need is sometimes desirable, with the result that the CFR can differ to the actual borrowing planned in the year.

It is not currently anticipated that any new borrowing will be undertaken during 2016/17.

Interest rates remain low, and the PWLB certainty rate, available to all authorities providing relevant information to CLG, allows the Council to take advantage of a discount of 20 basis points. Advice will be taken from CAS with regard to the amount and timing of any additional borrowing, and should conditions become advantageous, some borrowing in advance of need will also be considered by the Chief Financial Officer. Whilst borrowing rates may be historically low, so too are investment rates and serious consideration must be given to the cost of carrying any additional borrowing during the period prior to it being required for the financing of capital expenditure.

2.5 Debt rescheduling

Debt rescheduling opportunities are limited in the current economic climate, and due to the structure of interest rates. Advice in this regard will continue to be taken from CAS. No debt rescheduling has been undertaken during the period from 1 April to 30 June 2016.

2.6 Compliance with Prudential and treasury indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Full Council on 7 March 2016.

During the financial year to date the Council has at all times operated within the treasury limits and Prudential Indicators set out in the council's TMSS, and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators as at 30 June 2016 are shown at Appendix 3.

These indicators are based on estimates of expected outcomes, and are key indicators of "affordability". They are monitored on a quarterly basis, and Appendix 3 compares the approved indicators with the projected outturn for 2016/17, and shows variances on some of the indicators, as described below:

a) Prudential Indicators:

i) Capital Expenditure

The latest projected outturn shows that capital expenditure is expected to be £5,229,000. This differs to the original estimate of £4,366,900 due to the inclusion of approved carry-forward requests from 2015/16 and to approved variations to the capital programme during 2016/17.

ii) Capital Financing Requirement (CFR)

The projected closing CFR for 2016/17 is £12,739,500. This is lower than the approved indicator of £13,030,300, mainly due to slippage and savings on the 2015/16 capital programme which reduced the borrowing requirement in that year, and to variations to the 2016/17 programme.

iii) Ratio of Financing Costs to Net Revenue Stream

The projected outturn of 9.86% shows an increase on the approved indicator of 9.75%. This is due to a reduction in anticipated investment interest due to continuing uncertainty and poor rates in the market, and an increased revenue contribution to capital expenditure. These increases are offset by reductions in MRP, as a result of slippage and savings on the capital programme in 2015/16, and in serviced debt interest, due to the full redemption of the debt on 31 March 2016.

iv) Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2015/16 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The Council's gross debt at 30 June 2016 was £7.812m which was well within the approved indicator.

Treasury Management Indicators:

These indicators are based on limits, beyond which activities should not pass without management action. They include two key indicators of affordability and four key indicators of prudence.

Affordability

i) Operational boundary for external debt.
ii) Authorised limit for external debt.

Prudence

iii) Upper limit for fixed interest exposure – represented by the maximum permitted net outstanding principal sum borrowed at fixed rates. Please note that a negative indicator represents a position of net investment.

iv) Upper limit for variable interest rate exposure – represented by the maximum permitted net outstanding principal sum borrowed at variable rates. Please note that a negative indicator represents a position of net investment.

v) Maximum new principal sums to be invested during 2016/17 for periods in excess of 364 days - such investments are classified as a "non-specified". This indicator is subject to the overall limit for non-specified investments set in the TMSS.

vi) Upper limits for the maturity structure of borrowing - set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

Appendix 3 shows the actual position as at 30 June 2016, and demonstrates that all activities are contained within the currently approved limits.

Alternative Options

There are no alternative options, this report being a requirement of the Council's Treasury Management Strategy Statement (TMSS).

Financial Implications

No specific financial implications are attributable to this report, an adjustment to the budget for investment income being dealt with in the revenue budget monitoring report elsewhere on this agenda.

Appendices

1. Treasury Activity Report 2016/17 for quarter ended 30 June 2016.
2. Definitions of LIBOR and LIBID
3. Prudential and Treasury Indicators for 2016/17 as at 30 June 2016.

Background Papers

None identified.

Recommendation

That:

Members note the report, together with the Treasury Activity Report for Quarter 1 at Appendix 1, and the Prudential and Treasury Indicator Monitoring for Quarter 1 at Appendix 3.

Reasons for Recommendations

To comply with the requirements of the Council's Treasury Management Strategy Statement.

For more information, please contact:

Alison Ball, Financial Services Manager, on 0115 901 3980

Appendix 1

TREASURY ACTIVITY REPORT 2016/17

Quarter ended 30 June 2016

	Position @ 1 April 2016 £	Loans Made During Q1 £	Loans Repaid During Q1 £	Position @ 30 June 2016 £
Long Term Borrowing				
PWLB	7,811,577	0	0	7,811,577
Total Long Term Borrowing	7,811,577	0	0	7,811,577
Temporary Borrowing				
Local Authorities	0	5,500,000	(5,500,000)	0
Public Corporations	0	0	0	0
Central Government	0	0	0	0
Banks & Other Institutions	0	0	0	0
Total Temporary Borrowing	0	5,500,000	(5,500,000)	0
TOTAL BORROWING	**7,811,577**	**5,500,000**	**(5,500,000)**	**7,811,577**
Temporary Investment				
Bank of Scotland	(4,000,000)	(1,000,000)	0	(5,000,000)
Barclays	(1,000,000)	0	1,000,000	0
HSBC Treasury	0	(4,095,000)	4,095,000	0
Ignis Money Market Fund (Std Life)	0	(12,100,000)	8,900,000	(3,200,000)
Royal Bank of Scotland	0	0	0	0
Santander	(1,590,000)	(10,610,000)	7,540,000	(4,660,000)
Total Banks	(6,590,000)	(27,805,000)	21,535,000	(12,860,000)
Building Societies	(2,500,000)	0	0	(2,500,000)
Debt Management Office	0	0	0	0
Local Authorities & Other	0	0	0	0
TOTAL INVESTMENT (See below)	**(9,090,000)**	**(27,805,000)**	**21,535,000**	**(15,360,000)**
NET BORROWING / (INVESTMENT)	**(1,278,423)**	**(22,305,000)**	**16,035,000**	**(7,548,423)**

Temporary Borrowing & Investment Statistics at 30 June 2016

Investment:

Fixed Rate Investment	(7,500,000)	(5,095,000)	5,095,000	(7,500,000)
Variable Rate Investment	(1,590,000)	(22,710,000)	16,440,000	(7,860,000)
TOTAL INVESTMENT	**(9,090,000)**	**(27,805,000)**	**21,535,000**	**(15,360,000)**

Proportion of Fixed Rate Investment		48.83%
Proportion of Variable Rate Investment		51.17%
Temporary Investment Interest Receivable	£	22,443
Equated Temporary Investment	£	2,925,833
Weighted Average Interest Rate Received (Interest Receivable / Equated Investment)		0.77%
7 Day LIBID (Benchmark)		0.36%
3 Month LIBID		0.46%

Borrowing:

Temporary Brrowing Interest Payable	£	285
Equated Temporary Borrowing	£	90,411
Weighted Average Interest Rate Paid (Interest Payable / Equated Borrowing)		0.31%
7 Day LIBOR (Benchmark)		0.49%

Appendix 2

LIBOR - the London Interbank Offered Rate

LIBOR is the interest rate at which the London banks are willing to offer funds in the inter-bank market. It is the average of rates which five major London banks are willing to lend £10 million for a period of three or six months, and is the benchmark rate for setting interest rates for adjustable-rate loans and financial instruments.

ie. the London banks are LENDING to each other, which affects the rate at which the banks will lend to other parties eg. local authorities, ie. Gedling are BORROWING money

LIBID - the Interbank BID (LIBID) rate

LIBID is the interest rate at which London banks are willing to borrow from one another in the inter-bank market. It is the average of rates which five major London banks willing to bid for a £10 million deposit for a period of three or six months.

ie. the London banks are BORROWING from each other, which affects the rates at which they will borrow from other parties eg. local authorities, ie. Gedling are LENDING money.

Prudential Indicators for 2016/17
1 April to 30 June 2016

Appendix 3

	2016/17 Original Estimate (Council 7/3/16)	2016/17 Position at 30-Jun-16
1. Prudential Indicators		
Affordability:		
a) Capital Expenditure	£ 4,366,900	£ 5,229,000
b) Capital Financing Requirement	£ 13,030,300	£ 12,739,532
c) Ratio of Financing Costs to Net Revenue Stream	9.75%	9.86%
d) Incremental Impact of new 2016/17 Capital Investment Decisions:	£14.63	Not Applicable
e) Maximum Gross Debt	£ 13,030,300	£ 7,811,577
2. Treasury Management Indicators		
a) Operational Boundary for External Debt:		
Borrowing	£ 14,000,000	£ 7,811,577
Other Long Term Liabilities	£ 1,500,000	£ -
Total Operational Boundary	£ 15,500,000	£ 7,811,577
b) Authorised Limit for External Debt:		
Borrowing	£ 15,000,000	£ 7,811,577
Other Long Term Liabilities	£ 1,500,000	£ -
Total Authorised Limit	£ 16,500,000	£ 7,811,577
c) Upper limit for fixed interest rate exposure: (Maximum outstanding net BORROWING)	£ 13,000,000	£ 311,577
Additional Local Indicator - Investment Only	100.00%	48.83%
Additional Local Indicator - Borrowing Only	100.00%	100.00%
d) Upper limit for variable interest rate exposure: (Maximum outstanding net BORROWING)	£ 2,000,000	-£ 7,860,000
Additional Local Indicator - Investment Only	100.00%	51.17%
Additional Local Indicator - Borrowing Only	50.00%	0.00%
e) Upper & Lower limits for the maturity structure of outstanding Borrowing during 2016/17:		
Under 1 Year	U 40%, L 0%	13%
1 Year to 2 Years	U 40%, L 0%	0%
2 Years to 5 Years	U 50%, L 0%	0%
5 Years to 10 Years	U 50%, L 0%	0%
Over 10 Years	U 100%, L 0%	87%
f) Investment Treasury Indicator and limit: Max. NEW principal sums invested in-year for periods OVER 364 days (ie. non-specified), subject to maximum non specified per counterparty of £3m AND to the prevailing overall counterparty limit AND to the the TOTAL non specified limit of £5m.	£ 3,000,000	£ -