

Cherwell District Council

Accounts, Audit and Risk Committee

6 December 2016

Q2 Treasury Management Report

Report of Chief Finance Officer

This report is public

Appendix 1 is exempt from publication by virtue of paragraph 3 of Schedule 12A of Local Government Act 1972

Purpose of report

To receive information on treasury management performance and compliance with treasury management policy for 2016/17 as required by the Treasury Management Code of Practice.

1.0 Recommendations

The meeting is recommended:

- 1.1 To note the contents of the second quarter (Q2) Treasury Management Report.

2.0 Introduction

- 2.1 As part of the Council's investment strategy and governance arrangements this committee considers the investment performance to date and compliance with the Council's Treasury Management Strategy with regard to counterparties being used.
- 2.2 The Code of Practice on Treasury Management approved by the Chartered Institute of Public Finance and Accountancy (CIPFA) and adopted in full by the Council in 2004, requires that a Treasury Management Strategy is produced prior to the beginning of the financial year to which it relates.
- 2.3 The Treasury Management Strategy is the cornerstone of proper treasury management, and is central to the operation, management reporting and performance assessment. The new annual strategy for Cherwell District Council was approved at full Council on 22nd February 2016. The Council re-appointed Capita Asset Services (formerly Sector) as its Treasury Management advisor in January 2013.
- 2.4 The highest standard of stewardship of public funds remains of the utmost importance to the Council. This document details the Council's management of investments and treasury management activities during the 6 months of 2016/17.

3.0 Report Details

2016/17 Performance

- 3.1 At the end of September 2016 the Council had £44.5m managed in-house (including Eco Town funds of £11.5m) which fluctuates during the year. The Council regularly reviews each of these funds in the light of current economic conditions, reducing balances in investments planned to fund the Capital Programme and the need to contribute to efficiency savings.
Appendix 1 details the split of in-house funds by category and banking group.

Update on Cherwell's Treasury Performance

- 3.2 The new Treasury Management Strategy for 2016/17, which includes the Annual Investment Strategy, was approved by the Council on 22nd February 2016 and sets out the Council's investment priorities as being:

- Security of Capital; Liquidity; and Yield

- 3.3 The Council will aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover short term cash flow needs. The Council also seeks out value available in significantly higher rates in periods up to 12 months with highly credit rated financial institutions. The Council uses Capita's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information (this applies in particular to nationalised and semi nationalised UK banks).

Investment performance for 6 months ended 30 September 2016:

- 3.4 Investment rates available in the market have continued at historically low levels. The *average* level of funds available for investment purposes up to September 2016 was £44.9m. Funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants, funding of Graven Hill and progress on the Capital Programme and ECO Bicester.
- 3.5 The position as at 30 September 2016 shows:-

| Investment Amount £ | Interest Budget £ | Interest Actual £ | Variance £ | Annualised rate of return £ |
|--------------------------------|------------------------------|------------------------------|-----------------------|--|
| 44,497,585 | 87,500 | 130,597 | 43,097 | 0.58% |

- 3.6 Interest for the full year is forecast to be approximately £14k greater than budget, despite the reduction in base rates in August 2016. A major factor for this is the delayed payment of £12million to Graven Hill for the purchase of land from the MOD, which is now expected around December 2016.

- 3.7 The value of interest includes accrued interest on Gilts (only payable twice a year) and investments maturing after date.

Icelandic Investments

- 3.8 As covered in previous reports, the remaining Icelandic funds have now been repaid in full, with associated interest (not included in the above figures).

- 3.9 **Capita Asset Services provided the following reports for the quarter ended 30 September 2016:**

Economic Background

UK 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% year on year) 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 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 August 4th 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, Mark Carney, 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 November 23.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. 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 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.

In the Eurozone, the 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 was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

Interest Rate Forecast

| | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 |
|-----------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Bank rate | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% |
| 5yr PWLB rate | 1.00% | 1.00% | 1.10% | 1.10% | 1.10% | 1.10% | 1.20% | 1.20% | 1.20% | 1.20% | 1.30% |
| 10yr PWLB rate | 1.50% | 1.50% | 1.60% | 1.60% | 1.60% | 1.60% | 1.70% | 1.70% | 1.70% | 1.70% | 1.80% |
| 25yr PWLB rate | 2.30% | 2.30% | 2.40% | 2.40% | 2.40% | 2.40% | 2.50% | 2.50% | 2.50% | 2.50% | 2.60% |
| 50yr PWLB rate | 2.10% | 2.10% | 2.20% | 2.20% | 2.20% | 2.20% | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% |

Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August 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. Mark Carney, 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.

4.0 Conclusion and Reasons for Recommendations

4.1 This report details the Treasury Performance for the Council for the quarter ended 30 September 2016.

5.0 Consultation

None

6.0 Alternative Options and Reasons for Rejection

- 6.1 The following alternative options have been identified and rejected for the reasons as set out below.

Option 1: To request further information on the performance reported.

7.0 Implications

Financial and Resource Implications

- 7.1 There are no financial implications arising directly from any outcome of this report.

Comments checked by:

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Legal Implications

- 7.2 Presentation of this report is in line with the CIPFA Code of Practice.

Comments checked by:

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Risk Management Implications

- 7.3 It is essential that this report is considered by the Audit Committee as it demonstrates that the risk of not complying with the Council's Treasury Management Policy has been avoided

Comments checked by:

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Equality and Diversity

- 7.4 There are no equality and diversity implications from this report.

Comments checked by:

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8.0 Decision Information

Wards Affected

All wards are affected

Links to Corporate Plan and Policy Framework

Links to all elements of Corporate Plan

Lead Councillor

None

Document Information

| Appendix No | Title |
|----------------------------|--|
| Appendix 1 - EXEMPT | Schedule of In-house investments per category and banking group. |
| Background Papers | |
| None | |
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