

**REPORT TO:** Audit and Governance Committee

**MEETING DATE:** 29 November 2016

**BY:** Depute Chief Executive - Resources and People Services

**SUBJECT:** Treasury Management Strategy Statement and Annual Investment Strategy – Mid Year Review 2016/17

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## **1 PURPOSE**

- 1.1 To update the Committee on Treasury Management activity during the first half of 2016/17.

## **2 RECOMMENDATIONS**

- 2.1 The Committee are asked to note the content of the report

## **3 BACKGROUND**

- 3.1 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 a way which takes account of risk and return.
- 3.2 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.
- 3.3 Specialist Treasury Management advice is provided to the Council on a contractual basis by Capita Asset Services. This service includes daily market updates and regular review meetings. Operational decisions are made by the Service Manager - Corporate Finance in accordance with the approved Treasury Management Strategy, in consultation with the Head of Council Resources and after considering the advice provided by Capita Asset Services.

- 3.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:
- An economic update for the 2016/17 financial year to 30 September 2016;
  - A review of the Treasury Management Strategy Statement and Annual Investment Strategy approved by the Council on 23<sup>th</sup> February 2016;
  - A review of the Council's borrowing for 2016/17
  - A review of the Council's investment activity for 2016/17

#### **Extract from Economic update by Capita Asset Services**

- 3.5 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, prior to the outcome of the USA elections subsequent surveys had shown a sharp recovery in confidence.
- 3.6 The current situation is that markets remain uncertain in the wake of Donald Trump's election. There are concerns about how the President elect will interact with his colleagues on Capitol Hill, and what his policies actually are and how he plans to fund them.
- 3.7 The FTSE 100 fell as gold miners and other defensive stocks slipped amid expectations that there will be a large US economic stimulus based on President Trump's pledges of cuts and infrastructure spending. Meanwhile sterling made headway against the US Dollar as markets consider the Trump effect.
- 3.8 European markets edged lower as losses in utility stocks offset gains in the financial sector. With the triumphs of Brexit and Trump, there are concerns about the political risks within the Euro zone given the domestic elections facing member states, not least France. In the wake of this the Euro suffered, dropping low against Sterling.
- 3.9 Wall Street had a mixed session as the banking sector surged to levels not seen since 2008, but technology sank as investors reassessed the prospect of the Trump presidency.
- 3.10 The annualised decline in Japanese producer prices continues to weaken for a fourth straight month. Overall Asian markets saw shares stumble as soaring US bond yields raised concerns about outflows
- 3.11 Gilt sales say yields pushed to their highest level since the June Brexit vote, as investors were swept along by inflation expectations on Trump's spending plans and reduction in trade openness.
- 3.12 Interest rates were cut to the lowest ever levels as expected in the light of the Bank of England's post Brexit comments. There remains speculation

that there could be further stimulus to come. Rates are expected to remain low for a prolonged period of time.

3.13 The following table shows Capita Asset Services' forecast for interest rates:

	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%

### **Review of the Treasury Management Strategy Statement and Annual Investment Strategy.**

3.14 There are no policy changes to the Treasury Management Strategy Statement (TMSS) approved by the Council on 23 February 2016. No changes are required to the prudential indicators approved in the TMSS and approved prudential indicators have been complied with during the first six months of 2016/17.

### **Borrowing Update**

3.14 The Council's capital financing requirement (CFR) for 2016/17 is £399m. 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). This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

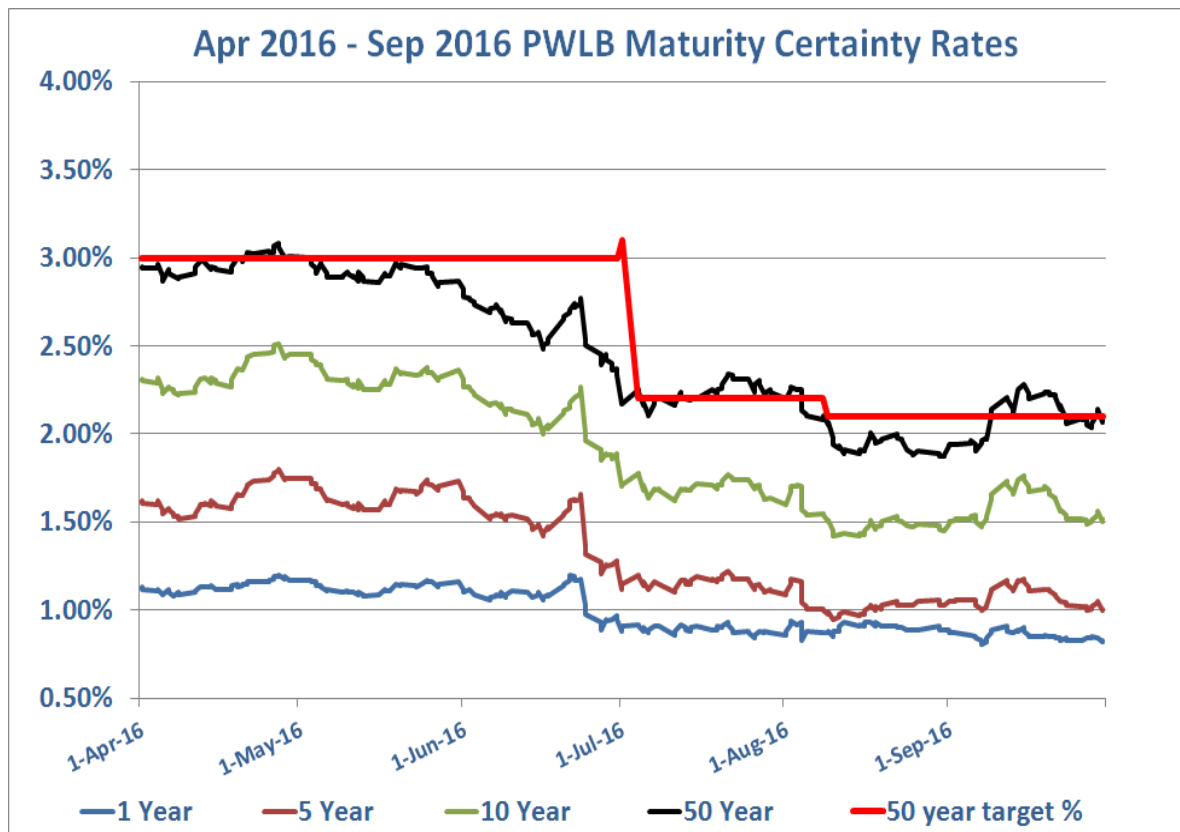
3.15 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement - CFR), new external borrowing of £20m was undertaken from the PWLB:

Date of Borrowing	Principal	Maturity	Interest Rate
28/06/16	£5m	46 years	2.49%
18/08/16	£5m	49 years	1.91%
18/08/16	£5m	43 years	1.91%
30/08/16	£5m	49 years	1.88%

3.16 The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date for comparison:

### PWLB Certainty Rates 1 April 2016 to 30 September 2016

	1 Year	5 Year	10 Year	25 Year	50 Year
1/4/16	1.13%	1.62%	2.31%	3.14%	2.95%
30/9/16	0.83%	1.01%	1.52%	2.27%	2.10%
Low	0.81%	0.95%	1.42%	2.08%	1.87%
Date	07/09/2016	10/08/2016	10/08/2016	12/08/2016	30/08/2016
High	1.20%	1.80%	2.51%	3.28%	3.08%
Date	27/04/2016	27/04/2016	27/04/2016	27/04/2016	27/04/2016
Average	0.99%	1.33%	1.92%	2.69%	2.46%



3.17 One PWLB loan matured during the first six months and was repaid:

Date repaid	Principal	Maturity	Interest rate
24/9/16	£5m	7 years	3.48%

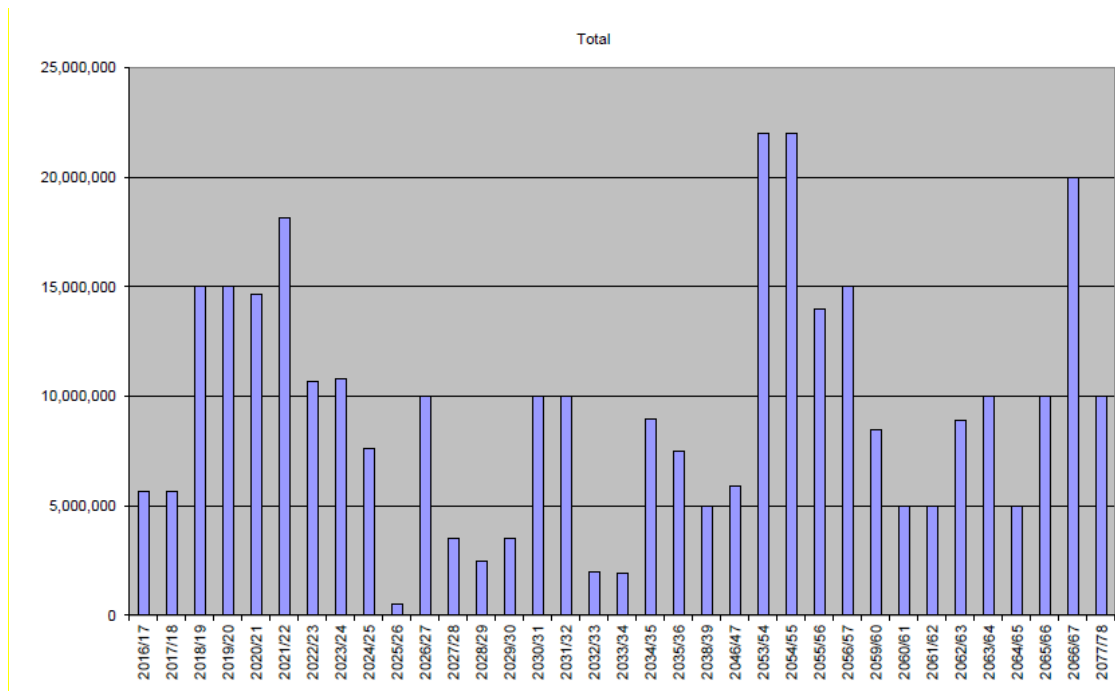
3.18 There were no short term loans taken and the following short term loan matured and was repaid:

Date of borrowing	Lender	Amount	Interest rate	Date repaid
29/03/16	Kensington & Chelsea	£5m	0.60%	26/09/16

3.19 Due to this the Council's overall external borrowings are £346m at 30 September.

3.20 There is a further maturity of £0.7m in December.

### Current Maturity Profile



- 3.21 We are monitoring our cash flow carefully and it is anticipated that further borrowing will be undertaken during this financial year. However should market conditions change the council is well placed to support any additional borrowing or investments activity that may arise.

### **Debt Rescheduling**

- 3.22 No debt rescheduling was undertaken during the first six months of 2016/17 as debt rescheduling opportunities have been limited in the current economic climate, with the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010.
- 3.23 In accordance with a request made by the Audit and Governance Committee, some exploratory work is being undertaken to assess any potential opportunity for review of the Council's existing contractual commitments under the PPP. The Committee will be kept up to date with any developments as they become known.

### **Investment Update**

- 3.23 Investment decisions during the first 6 months of 2016/17 were taken in accordance with the approved strategy. There were no new investments during the period and surplus cash balances were held in the Council's bank account, East Lothian Council Common Good funds and Charitable Trust funds are managed in two separate portfolios by an external investment management company, Investec. At 30 September 2016, the East Lothian Charitable Trust portfolio was valued at £3.091m, which represents an increase of £0.284m over the 6 month period. The Common Good portfolio was valued at £3.143m which represents an increase of £0.294m over the 6 month period.

## **4 POLICY IMPLICATIONS**

- 4.1 There are no direct policy implications associated with this report however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

## **5 EQUALITIES IMPACT ASSESSMENT**

- 5.1 This report is not applicable to the well being of equalities groups and Equality Impact Assessment is not required.

## **6 RESOURCE IMPLICATIONS**

- 6.1 Financial - There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel – None

6.3 Other - None

## **7 BACKGROUND PAPERS**

7.1 Treasury Management Strategy 2016/17 to 2018/19 – East Lothian Council 23 February 2016.

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