POLICY & RESOURCES COMMITTEE	Agenda Item 83 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement 2015/16 (including Annual Investment Strategy 2015/16) – Mid Year Review**	
Date of Meeting:		**3 December 2015**	
Report of:		**Interim Executive Director of Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 29-1242**
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Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2015/16 Treasury Management Policy Statement (TMPS), practices and schedules were approved by Policy & Resources on 19 March 2015. The TMPS sets out the role of Treasury Management, whilst the practices and schedules set out the annual targets and methods by which these targets will be met.

1.2 The TMPS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash funds and was approved by Full Council on 26 March 2015.

1.3 It is recommended good and proper practice that Members receive half yearly reports and review and endorse treasury management actions during the year. The purpose of this report is to advise members of the actions taken in the first half of 2015/16.

2. RECOMMENDATIONS:

2.1 That Policy & Resources Committee endorses the key actions taken during the first half of 2015/16 to meet the treasury management policy statement and practices (including the investment strategy) as set out in this report.

2.2 That Policy & Resources Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised limit and operational boundary have not been exceeded in the first half of the year.

3. CONTEXT/ BACKGROUND INFORMATION

Overview of Markets

3.1 The UK economy had seen the strongest growth rates of the G7 in 2013 and 2014 at 2.2% and 2.9% respectively. However, quarter 1 of 2015 was weaker at +0.4% though there was a rebound in quarter 2 to +0.7%. Growth slowed again in Q3 to 0.5%. The weaker growth was as a result of the biggest fall in construction output in three years, and a further contraction of the manufacturing output, which has therefore seen the sector contracting for three consecutive quarters. The services sector grew strongly in the quarter, indicating that economic recovery is heavily reliant on this sector, as opposed to the broad-based approach desired by the Bank of England Monetary Policy Committee. Looking ahead, the increases in consumer credit, which demonstrates strong consumer demand, should offset a weakening global outlook. This would suggest that the dip in growth in Q3 is not indicative of a start toward lower growth.

3.2 CPI Inflation dipped back into negative territory in September 2015 for the second time this year The drop in the price of fuel played a significant part in this, while the recent fall in the price of clothing also kept core prices (which exclude certain more volatile elements such as energy and food costs) subdued. With the Monetary Policy Committee (MPC) not expecting a pickup in inflation until the turn of the year, a temporary bout of deflation is seen as beneficial for the UK economy; households are seeing a boost in their spending power, with the economy likely to benefit in terms of growth.

3.3 There has been a weakness in some global economic announcements in recent weeks. Those from China, Japan and the Eurozone are not unexpected but those out of the US and, to a lesser extent, the UK are raising doubts about the prospects of an early interest rate rise. This data has persuaded the Federal Reserve not to raise rates at this time. This leaves markets and investors guessing about when conditions will be right for the central bank to act. The UK is highly unlikely to raise rates ahead of the US, and with UK data starting to lose some of its strength, the potency of economic recovery is starting to be questioned by the markets. As a consequence, the expectations of a UK rate increase have been pushed deeper into 2016, with some analysts now suggesting that it could even be 2017 before there is any Bank of England action.

3.4 The delay in any increase in the Bank Rate is likely to suppress the council's income from its investment portfolio. However, long term borrowing rates are also suppressed in the current market, and therefore borrowing requirements for capital projects will be at a lower cost than earlier projections. However, as a result of the differential between investment rates and borrowing rates, any new borrowing that is entered into will generate a cost of carry until investment rates improve. A delay in rate increase could therefore impact on the cost of undertaking the potential borrowing activity detailed in paragraphs 3.16 to 3.19. Therefore, interest rate forecasts will be kept under close scrutiny and reviewed before any new borrowing is entered into.

Treasury Management Strategy

3.5 A summary of the action taken in the 6 months to September 2015 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in the September 2015 Bulletin at Appendix 2. The main points are:

- The council entered into £12.010m of new borrowing arrangements during the period to support the construction of the i360;
- The highest risk indicator during the period was 0.036% which is below the maximum set of 0.05%;
- The return on investments by the in-house treasury team and cash manager has exceeded the target rates.

- The two borrowing limits approved by full Council have not been exceeded.

3.6 Treasury management activity in the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Apr 2015 to 30 Sep 2015			
	Fixed deposits	Money market funds	Total	
Up to 1 week	-	£220.1m	£220.1m	80%
Between 1 week & 1 month	£5.0m	-	£5.0m	2%
Between 1 month & 3 months	£19.5m	-	£19.5m	7%
Over 3 months	£29.0m	-	£29.0m	11%
	£53.5m	**£220.1m**	**£273.6m**	**100%**

Summary of Treasury Activity April to September 2015

3.7 The following table summarises the treasury activity in the half year to September 2015 compared to the corresponding period in the previous year.

April to September	2014/15	2015/16
Long-term borrowing repaid	-	£0.2m
Short-term borrowing repaid	-	-
Investments made	£303.3m	£273.6m
Investments maturing	(£296.6m)	(£255.3m)

3.8 The Financing Costs budget reported a £0.133m underspend at Month 7. This is mainly as a result of cash balances being higher than expected, which has negated the need for short term borrowing to help fund cash flow. The saving is therefore a combination of higher than expected interest on cash balances and lower short term borrowing costs.

3.9 The following table summarises how the day-to-day cash flows in the first half-year have been funded compared to the same period in the previous year.

April to September	2014/15	2015/16
Cash flow surplus – general	£11.3m	£8.0m
Net cash flow surplus	**£11.3m**	**£8.0m**
Represented by: Increase in long-term borrowing Decrease in short-term borrowing Increase in investments (Increase)/decrease in bank balance	 - - (£6.7m) (£4.6m)	 £11.8m (£2.0m) (£18.3m) £0.5m

Security of Investments

3.10 A summary of investments made by the in-house treasury team and outstanding as at 30 September 2015 in the table below shows that investments continue to be held in good quality, short term instruments. The funds invested in BBB institutions included in the table below are invested in the part-nationalised banks which are backed by a Government guarantee in line with the AIS.

‘AAA’ rated money market funds	£12.84m	21%
‘AA’ rated institutions	£0.00m	0%
‘A’ rated institutions	£48.00m	76%
‘BBB’ rated institutions	£2.01m	3%
Total	**£62.85m**	**100%**
Period – less than one week	£15.84m	25%
Period – between one week and one month	£5.50m	9%
Period – between one month and three months	£13.50m	21%
Period – between three months and 1 year	£28.01m	45%
Total	**£62.85m**	**100%**

Risk

3.11 As part of the investment strategy for 2015/16 the Council agreed a maximum risk benchmark of 0.05% i.e. there is a 99.95% probability that the council will receive its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.020% and 0.036% between April 2015 and September 2015. It should be remembered however that the benchmark is an average risk of default measure, and does not constitute an expectation of loss against a particular investment.

3.12 In January 2015, Internal Audit undertook an audit of the treasury management function. The audit concluded that “reasonable assurance” is provided on the effectiveness of the control framework operating and mitigating risks for treasury management. The audit recommended an improvement in the control environment to ensure greater independence in the reconciliation of treasury activity. These arrangements have subsequently been put in place.

Performance

3.13 The following table summarises the performance on investments compared with the budgeted position and the benchmark rate.

(*) Annualised rates	In-house investments		Cash manager investments	
	Average balance	Average rate (*)	Average balance	Average rate (*)
Budget 2015/16– full year*	£57.0m	0.60%	£25.5m	%
Actual to end Sept 2015	£77.5m	0.66%	£25.6m	%
Benchmark rate (i.e. 7 day LIBID Rate) to end Sept 2015	-	0.36%	-	0.38%

**please note this is an average for the full year –profile of balances are higher in the first half of the year and are expected to reduce over the financial year.*

3.14 The cash manager fund has maintained its AAA rating during the period, so the authority's investment in this fund has remained very secure. The performance of the fund has declined over the last 6 months. Officers are closely monitoring the performance of the fund and, alongside treasury advisors, officers are looking at alternative solutions for investing this cash to ensure the council can optimise its return without compromising the security of the investment.

3.15 The council is now part of a regional benchmark club which shares investment strategies and performance on a confidential basis. The latest benchmarking data demonstrates that the council's investment portfolio is performing in line with expectations.

Borrowing Strategy

3.16 Over recent years the council has been following a strategy of repaying debt and funding its borrowing requirement through utilising cash balances which were supporting the council's reserves and balances. This is a prudent strategy which has allowed the council to minimise the cost of carry on its borrowing, and reduce its counterparty exposure risk. The approved 2015/16 TMPS presented to Policy & Resources Committee on 19 March 2015 included a change in approach as a result of a number of contributing factors; an expectation of increases in interest rates next year, the expected reduction of certain reserves over the next 4 years, and the forward borrowing opportunities expected in the local authority market. As a result, the 2015/16 budget included provision to enter into some short term borrowing before the first phase of forward borrowing was expected to be drawn down during 2016/17.

3.17 The forward borrowing opportunities have not yet become available and it is appearing increasingly unlikely that any products will become available. Consequently it has been necessary for officers to explore alternative sources of borrowing in order to maintain appropriate levels of liquidity over the next 4 years, and to ensure the council is mitigating its exposure to rising interest rates.

3.18 PWLB rates have been volatile in the last year, and have reached historic lows in the last 6 months. Following analysis of borrowing costs and interest rate forecasts, in consultation with the council's Treasury Advisors, "trigger" rates have been determined to potentially undertake two tranches of PWLB borrowing in 2015/16. The PWLB rates are published twice a day and officers are pro-actively monitoring these rates; if the rates reduce to or below the first trigger rate set, £5.000m borrowing will be undertaken and a subsequent £5.000m will be undertaken if a second trigger rate is met subject to a reassessment of interest rate forecasts as outlined in paragraph 3.4.

3.19 This will allow the council to take advantage of the dips in rates during this volatile period. This borrowing will replace the short term borrowing budgeted for in 2015/16 and the £0.133m Financing Costs underspend forecast assumes both tranches of borrowing will be undertaken. If trigger rates are not hit, and this borrowing is not undertaken in 2015/16, there will be a potential further £0.075m saving against the 2015/16 budget, but with the potential impact of increasing costs in future years.

Treasury Advisors

3.20 The council's current contract with Capita Asset Services expires on 30 November 2015. Procurement for a new 3 year treasury advisor contract is underway via a framework agreement for Professional Services.

Minimum Revenue Provision Review

3.21 The council is required to set aside a provision each year towards repaying it's debt – called Minimum Revenue Provision (or MRP). Each year full Council agree the MRP statement as part of the General Fund Revenue Budget and Council Tax report.

3.22 The council's current level of provision is around £8-9m per year. A one-off piece of work has been commissioned to analyse the council's historical application of MRP and outline revised MRP Policy options to allow the council to change the profile of its MRP.

3.23 The review will result in a robust revised MRP Policy which will be presented with the budget report to Budget Policy & Resources Committee on 11 February 2015. The revised policy is expected to result in a smoother profile of MRP, which will in turn free up revenue budget in the early years. Expected savings are difficult to quantify until the review is completed, but experience from other local authorities of a similar size who have already made a change in MRP policy implies minimum potential savings of £0.5m.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the 6 months to September 2015. Treasury management actions have been carried out within the parameters of the AIS, TMPS and Prudential Indicators. Therefore, no alternative options have been considered.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation was undertaken.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils this requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

<u>Financial Implications:</u>

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.8.

Finance Officer Consulted: James Hengeveld Date: 05/11/15

Legal Implications:

7.2 The TMPS and associated actions are exercised under powers given to the council by Part 1 of the Local Government Act 2003 which includes the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

Lawyer Consulted: Elizabeth Culbert *Date: 09/11/15*

Equalities, Sustainability and other significant implications:

7.3 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. A summary of the action taken in the period April 2015 to September 2015

2. September 2015 Treasury Management Bulletin

Documents in Members' Rooms

None

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations

2. The Treasury Management Policy Statement and associated schedules 2015/16 approved by Policy & Resources Committee on 19 March 2015

3. The Annual Investment Strategy 2015/16 approved by full Council on 26 March 2015

4. Treasury Management Policy Statement 2015/16 (including Annual Investment Strategy 2015/16) – End of year Review approved by Policy & Resources Committee on 9 July 2015

5. Papers held within Finance

6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2011