**TO: GOVERNANCE AND AUDIT COMMITTEE**
**25 JANUARY 2017**

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## TREASURY MANAGEMENT REPORT 2017/18 AND 2016/17 MID-YEAR REVIEW
**(Borough Treasurer)**

## 1 PURPOSE OF DECISION

1.1 The Council must operate a balanced budget, which broadly means cash raised during the year plus any use of reserves will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity before considering maximising investment return.

1.2 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 longer term cash flow planning needs 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.

1.3 The Local Government Act 2003 requires a local authority to "have regard to" guidance issued by, or specified by, the Secretary of State. As such, the Council is required to have regard to the Prudential Code and the Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

1.4 The Code of Practice requires the Council's annual Treasury Management Strategy (and associated documents) to be examined and reviewed by a responsible body. An additional primary requirement of the code is for the receipt by Full Council of a Mid-Year Review of the Treasury Management activities of the authority.

1.5 This report seeks to achieve both these requirements of updating Members on progress in 2016/17 and to review the Treasury Management Report for 2017/18.

## 2 RECOMMENDATIONS

**2.1 That the Committee consider and review the Mid-Year Review Report.**

**2.2 That the Committee agree that the Mid-Year Review Report be circulated to all Members of the Council.**

**2.3 That the Committee review the Treasury Management Report for 2017/18 prior to its approval by Council.**

## 3 REASONS FOR RECOMMENDATIONS

3.1 The reasons for the recommendations are set out in the report.

## 4 ALTERNATIVE OPTIONS CONSIDERED

4.1 The Code of Practice requires the Council's annual Treasury Strategy to be examined and reviewed by a responsible body and for that body to review progress of the Council's treasury management activities. The Governance and Audit Committee has been nominated by Council to be that body.

## 5 SUPPORTING INFORMATION

### Mid-Year Review

5.1 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first nine months of 2016/17
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure
- A review of the Council's investment portfolio for 2016/17
- A review of compliance with Treasury and Prudential Limits for 2016/17

### Economic Update

5.2 UK GDP growth rate 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 has been fairly robust at +0.6% q/q, +2.2% y/y in quarter 3 of 2016 to confound the pessimistic forecasts by the Bank of England in August and by other forecasters, which expected to see near zero growth during 2016 after the referendum. Prior to the referendum, the UK economy had been facing headwinds for exporters from the appreciation of sterling against the Euro plus weak growth in the EU, China and emerging markets, and 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, there was then a sharp recovery in confidence and business surveys and the fall in the value of sterling has had a positive effect in boosting manufacturing in the UK due to improved competitiveness in world markets.

5.3 The Bank of England meeting on 4th August addressed its forecast of a slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report cut the forecast for growth in 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. While the MPC was prepared to cut Bank Rate again by the end of 2016, Carney also warned that the Bank could not do all the heavy lifting and suggested that the Government would 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 would be eased in the Autumn Statement on November 23 and which he duly delivered.

5.4 The robust growth in quarter 3 of +0.6%, plus forward indicating business surveys also being very positive on growth, caused the MPC in November to pull back from another cut in Bank Rate. The November Inflation Report also included a forecast for inflation to rise to around 2.7% in 2018 and 2019, well above its 2% target, due to a sharp rise in the cost of imports as a result of the sharp fall in the value of sterling after the referendum. 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.

**Treasury Management Strategy Statement Review**

5.5 The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by the Council on 24th February 2016. There are no policy changes to the TMSS.

**Capital Expenditure**

5.6 The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed by Full Council. Any projected overspends will be addressed before the end of the financial year.

| Department | Approved Budget 2016/17 £'000s | Cash Budget 2016/17 £'000s | Estimated Out-turn 2016/17 £'000s | Cash Budget 2017/18 £'000s | (Under) /Over Spend £'000s |
|---|---|---|---|---|---|
| Adult Social Care, Health & Housing | 10,808.8 | 10808.8 | 7,679.0 | 0 | 0 |
| Children, Young People and Learning | 42,561.4 | 21,492.6 | 5,427.7 | 21,068.8 | 0 |
| Council Wide | 10,998.8 | 4,930.0 | 2,379.9 | 6,068.8 | -86.4 |
| Corporate Services | 4,903.8 | 4,697.3 | 4,511.7 | 206.5 | -147.2 |
| Environment, Culture & Communities | 31,228.7 | 24,751.8 | 10,317.7 | 6,476.9 | 6.4 |
| **TOTAL CAPITAL PROGRAMME** | 100,501.5 | 66,680.5 | 30,316.0 | 33,821 | (227.2) |

**Review of Investment Portfolio 2016/17**

5.7 The Council held £17.091m of investments as at 31 December 2016 and the investment portfolio yield for the first nine months of the year is 0.42% against a benchmark (Local Authority 7-Day Rate) of 0.24%.

| Investment | Maturity | Amount (£) | Average Rate (%) |
|---|---|---|---|
| **Money Market Funds** | | | |
| Standard Life Liquidity Fund | 1 Day | 2,797,000 | 0.43 |
| Black Rock Sterling Liquidity | 1 Day | 100,000 | 0.39 |
| Federated Prime Rate | 1 Day | 6,997,000 | 0.43 |
| Goldman Sachs | 1 Day | 100,000 | 0.36 |
| Aberdeen Liquidity | 1 Day | 6,997,000 | 0.44 |
| Deutsche Managed Sterling Fund | 1 Day | 100,000 | 0.34 |
| Total Investments | | **17,091,000** | |

5.8 The 2016/17 interest budget assumed that an average interest rate of 0.5% would be earned on the Council's investment portfolio. However the cut in interest rates to 0.25% by the Bank of England in August 2016 following the result of the European Referendum resulted in short-term investment rates falling to approximately 0.4% limiting the interest earned on investments.

5.9 However cash balances remain significantly on the upside largely as a result of the delay to some of the Council's major capital schemes. This enabled the Council to make a significantly larger pre-payment of the annual Pension liability than had been budgeted for. By making a one-off payment at the beginning of the year, rather than 12 equal instalments, the Council receives a discount of almost 3% - generating additional income of £223,000. In addition to this, the positive cash-flow over the first 9 months of the year will generate additional interest of approximately £180,000. This additional income has been reported in the Council's monthly budget monitoring reports. This is a one-off gain as cash resources will reduce as capital schemes complete.

**Compliance with Treasury and Prudential Limits for 2016/17**

**5.10** The Borough Treasurer can confirm that the approved limits within the Annual Investment Strategy were not breached during the first nine months of 2016/17 and no changes to these limits are proposed for the remaining 3 months.

**Treasury Management Report 2017/18**

5.11 The Council is required to have regard to the Prudential Code and Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Under these requirements the Council must set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. At its meeting on 2 March 2011 Council nominated the Governance and Audit Committee as the responsible body to examine and assess the effectiveness of the treasury management strategy and policies and recommend them to Council.

5.12 The attached Treasury Management Report 2017/18 (annex A) was approved by the Executive, as a part of the Council's overall budget proposals, on 13 December 2016 and outlines the Council's Prudential Indicators for 2017/18 to 2019/20 in addition to setting out the expected treasury strategy and operations for this period. The Executive requested that the Governance and Audit Committee review each of the key elements. Following this review the Treasury Management Report and associated documents will be presented to Council for approval on 14 February 2017.

5.13 The Bank Rate (set monthly by the Bank of England) remained at 0.5% until the action taken by the Bank of England to settle financial markets following the EU Referendum result in June 2016. Interest rates were cut to 0.25% and markets expected a further reduction to 0.10% by December 2016 based on the projections provided by the Bank of England in the November Inflation report. The Treasury Management Report approved by Executive in December was based on these assumptions.

5.14 However, economic statistics since late November have indicated stronger growth than the MPC expected in August; also, inflation forecasts have risen substantially as a result of the sharp fall in the value of sterling since early August. As such markets are no longer factoring in a further cut at this stage and expectations are for rates to remain at .025% for an increased period of time. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects already adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.5% is not tentatively expected until quarter 2 2019, after negotiations have been concluded (based on the Government's latest plans). However if strong domestically generated inflation were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

| | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.25% | 0.50% | 0.50% | 0.75% | 0.75% |
| 5yr PWLB rate | 1.60% | 1.60% | 1.60% | 1.60% | 1.70% | 1.70% | 1.70% | 1.80% | 1.80% | 1.90% | 1.90% | 2.00% | 2.00% |
| 10yr PWLB rate | 2.30% | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.40% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% |
| 25yr PWLB rate | 2.90% | 2.90% | 2.90% | 3.00% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% |
| 50yr PWLB rate | 2.70% | 2.70% | 2.70% | 2.80% | 2.80% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% |

5.15 This change in forward projections of interest rates (highlighted above) is reflected in the Treasury Management Report attached, which has now been updated since it was initially published in December 2016. This is however a relatively small change and has not substantially affected long-term borrowing costs that the Council may face over the next three years – as such there is no need at present to amend any of the figures included within the Council's original budget proposals in relation to investment income or debt costs. However given the uncertain economic conditions over the next 2-years these will be regularly reviewed and reported on through the Council's budget monitoring processes.

## 6 ADVICE RECEIVED FROM STATUTORY AND OTHER OFFICERS

Borough Solicitor

6.1 None.

Borough Treasurer

6.2 The financial implications are contained within the report.

Equalities Impact Assessment

6.3 None.

Strategic Risk Management Issues

6.4 The Treasury Management Report deals directly with the strategic management of risk associated with the Council's treasury management activities

## 7 CONSULTATION

Principal Groups Consulted

7.1 The Overview & Scrutiny Commission was consulted on the budget proposals, including the Treasury Management Strategy, in December.

Background Papers

None

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