Report To:	**EXECUTIVE CABINET**
Date:	14 December 2016
Executive Member /Reporting Officer:	Councillor J. Fitzpatrick - First Deputy (Performance & Finance); Ian Duncan – Assistant Executive Director (Finance)
Subject:	**TREASURY MANAGEMENT ACTIVITIES**
Report Summary:	This report provides a mid-year review of the Council's Treasury Management activities for 2016/17, including the borrowing strategy and the investment strategy.
Recommendations:	That the reported treasury activity and performance be noted.
Links to Community Strategy:	The Treasury Management function of the Council underpins the ability to deliver the Council's priorities.
Policy Implications:	In line with Council Policies.
Financial Implications: (Authorised by the Section 151 Officer)	Over the year to date, the Council has moved to a more diverse portfolio involving more foreign banks and more longer-duration investments in order to achieve an enhanced return in the current low interest rate environment. All counterparties used have been selected on the basis that they are highly rated and meet the criteria set out in the Council's Treasury Management Strategy. The Council held £159.980m of investments as at 30 September 2016 (£156.400m at 31 March 2016) and the investment portfolio yield to date is 0.51% against LIBID of 0.28%. This return has largely been earned due to an increased number of longer-duration investments. The average fixed term investment placed by the Council in 2016/17 to date has been 179 days, compared to 134 days in 2015/16
Legal Implications: (Authorised by the Borough Solicitor)	The achievement of savings on the cost of financing the Council's debt through repayment, conversion and rescheduling, together with interest earned by investing short term cash surpluses, is a crucial part of the Council's medium term financial strategy. This has to be carefully balanced against the level of risk incurred.
Risk Management:	Failure to properly manage and monitor the Council's loans and investments could lead to service failure and loss of public confidence.
Access to Information:	The background papers relating to this report can be inspected by contacting Beverley Stephens, Head of Resource Management, by: phone: 0161 342 3887 e-mail: Beverley.stephens@tameside.gov.uk

1. BACKGROUND

1.1 Cash-flow management is a core element of the Council's financial management activities. The Council operates a balanced budget, which broadly means cash raised during the year will meet cash expenditure. Treasury Management operations firstly ensure that cash flow is adequately planned, with short term surplus funds being invested. The investment strategy priorities are security (i.e. there is a low risk that the counterparty will default on the Council's investment), then liquidity (cash flow needs), and lastly, yield – providing adequate liquidity initially before considering maximising investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital investment plans, agreed as part of the annual budget setting process and updated throughout the financial year. These capital plans provide a guide to the borrowing need of the Council, essentially this is the long term cash flow planning to ensure the Council can meet its capital spending requirements. 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 management or cost reduction objectives.

1.3 Accordingly, treasury management is defined as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

2. INTRODUCTION

2.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011) was adopted by this Council on 8 February 2012. The primary requirements of the Code are as follows:

i. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
ii. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
iii. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, **a Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.
iv. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
v. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Overview (Audit) Panel.

2.2 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 six months of 2016/17;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2016/17;
- A review of the Council's borrowing strategy for 2016/17;
- A review of any debt rescheduling undertaken during 2016/17;
- A review of compliance with Treasury and Prudential Limits for 2016/17;

3. ECONOMIC UPDATE

3.1 The following economic update is provided by the Council's treasury management advisors, Capita:

3.2 The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

3.3 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.

3.4 The Monetary Policy Committee, (MPC), meeting of 4 August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Base Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

3.5 The MPC meeting of 3 November left Base Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Base Rate again, probably by the end of the year if economic data turned out as forecast by the Bank.

3.6 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 Monetary Policy Committee (MPC) is expected to look through 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.

3.7 On 23 November, Chancellor Phillip Hammond delivered the Government's first Autumn Statement since Britain voted to leave the European Union (EU). This included news that the Office for Budgetary Responsibility (OBR) has revised down its UK growth forecasts from 2017 onwards further than in the March Budget. The OBR expects growth of 2.1% in 2016, from the 2.0% they had predicted in the March Budget due to the momentum created in the run up to the EU Referendum and post-Referendum performance. The future years growth forecast have been lowered due to the potential of lower output over the next five years, largely as a result of Brexit uncertainties.

3.8 Although the deficit has fallen over the last six years, reaching 4.0% of GDP last year, debt and borrowing remain high. Given the result of the EU Referendum, the OBR no longer predicts a budget surplus by 2019/20, as it had done it in March Budget. The Chancellor announced three new fiscal rules in a new Charter for Budget Responsibility. This will pledge that the public finances should be returned to balance as early as possible in the next Parliament, and that borrowing (adjusted to reflect the economic cycle) should be below 2% by the end of this Parliament. The second rule commits public sector net debt as a share of GDP to be falling by the end of this Parliament, and a third to maintaining welfare spending in a cap set by the Government and monitored by the OBR.

3.9 Further, public sector net borrowing is forecasted to be higher than the March Budget in every year, highlighting the predicted impacts of lower economic growth on tax revenues. Compared to the March 2016 Budget, the Chancellor will have to borrow a further £122bn over the next five years.

3.10 The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, the first estimate for quarter 3 at 2.9% signalled a rebound to strong growth. The Fed embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December 2016. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis.

3.11 The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

3.12 Donald Trump's election has had a profound effect on the bond market and bond yields have risen sharply since his election. Time will tell if this is a temporary over reaction, or a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

3.13 In the Eurozone, 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 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.

3.14 Japan is still bogged down in anaemic growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

3.15 Capita's view on the outlook for the remainder of 2016/17 is as follows:-
Economic forecasting remains difficult with so many external influences weighing on the UK. Our Base Rate forecasts (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

We have pointed out consistently that the Fed. Rate is likely to go up more quickly and more strongly than Base Rate in the UK and recent events have not changed that view, just that the timing of such increases may well have been deferred somewhat during 2016. While there is normally a high degree of correlation between the two yields, we would expect to see a growing decoupling of yields between the two i.e. we would expect US yields to go up faster than UK yields. We will need to monitor this area closely and the resulting effect on PWLB rates.

The overall balance of risks to economic recovery in the UK remains to the downside, particularly with the current uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

3.16 Capita's view on the anticipated future movement in interest rates is shown below.

	NOW	Dec-16	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	0.25	0.25	0.50	0.50	0.75	0.75
3 month LIBID	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.60	0.70	0.80	0.90
6 month LIBID	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.70	0.80	0.90	1.00
12 month LIBID	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.80	0.80	0.90	1.00	1.10	1.20	1.30	1.40
5 yr PWLB	1.50	1.60	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
10 yr PWLB	2.30	2.30	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
25 yr PWLB	3.00	2.90	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
50 yr PWLB	2.70	2.70	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

The above Capita forecasts for Public Works Loan Board rates incorporate the Public Works Loan Board certainty rate, reducing Public Works Loan Board borrowing rates by 0.20%.

4. TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY UPDATE

4.1 The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by the Council on 10 February 2016.

4.2 There are no required policy changes to the TMSS; the details in this report update the position in the light of the current economic position and budgetary changes already approved.

4.3 The Council has moved to a more diverse portfolio involving more foreign banks and more longer-duration investments in order to achieve an enhanced return in the current low interest rate environment. All counterparties used have been selected on the basis that they are highly rated and meet the criteria set out in the Council's Treasury Management Strategy.

5. THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

5.1 The Prudential Indicators are reported on a quarterly basis as part of the Capital Monitoring process. The table at 5.3 below shows the current position against the Prudential Indicator limits initially set as part of the 2016/17 Budget Report.

5.2 The indicators are updated from the Capital Programme as at October 2016, showing the Council's capital expenditure plans and how these plans are being financed. Any changes in the capital expenditure plans will impact of the on the prudential indicators and the underlying need to borrow.

5.3 The current prudential indicator position is shown below. All the indicators are within the set limits showing that the Council's borrowing strategy remains a prudent one.

Prudential Limits

Actuals v limits as at 2nd November 2016

	limit	Actual at 02/11/2016	amount within limit
	£000s	£000s	£000s
Operational Boundary for External Debt	£268,176	£119,172	-£149,004
Authorised Limit for External Debt	£288,176	£119,172	-£169,004
Upper Limit for fixed	£199,173	-£28,416	-£227,589
Upper Limit for variable	£66,391	-£17,335	-£83,726
Capital financing requirement	£199,173	£189,253	-£9,920
Capital expenditure	£69,211	£56,556	-£12,655

Prudential Indicators

Gross borrowing and the capital financing requirement	CFR @ 31/03/16 + increase years 1,2,3	Gross borrowing at 02/11/2016	amount within limit
	£000s	£000s	£000s
	£199,173	£119,172	-£80,001

Maturity structure for borrowing 2016/17

Fixed rate

Under 12 months	0% to 15%	0.87%
12 months and within 24 months	0% to 15%	5.16%
24 months and within 5 years	0% to 30%	0.86%
5 years and within 10 years	0% to 40%	4.03%
10 years and above	50% to 100%	89.07%

6. INVESTMENT PORTFOLIO 2016/17

6.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.25% Base Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk strategy. Given this risk environment, investment returns are likely to remain low.

6.2 The Council held £159.980m of investments as at 30 September 2016 (£156.400m at 31 March 2016) and the investment portfolio yield to date is 0.51% against LIBID of 0.28%.

6.3 As outlined in paragraph 4.3, above, this return has largely been earned due to an increased number of longer-duration investments. The average fixed term investment placed by the Council in 2016/17 to date has been 179 days, compared to 134 days in 2015/16

6.4 The Assistant Executive Director (Finance) confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2016/17.

6.5 The Council's 2016/17 budget shows that external loans will incur interest charges of £5.955 and £0.675m will be paid to various Council funds such as the Insurance Fund. Investment income to be earned during the year is estimated to reduce these costs to give a net interest charge budget of £4.892m.

6.6 As outlined in the Treasury Management Strategy, the Council uses the Capita Asset Services creditworthiness service to inform counterparty selection.

6.7 The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

6.8 Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

6.9 All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

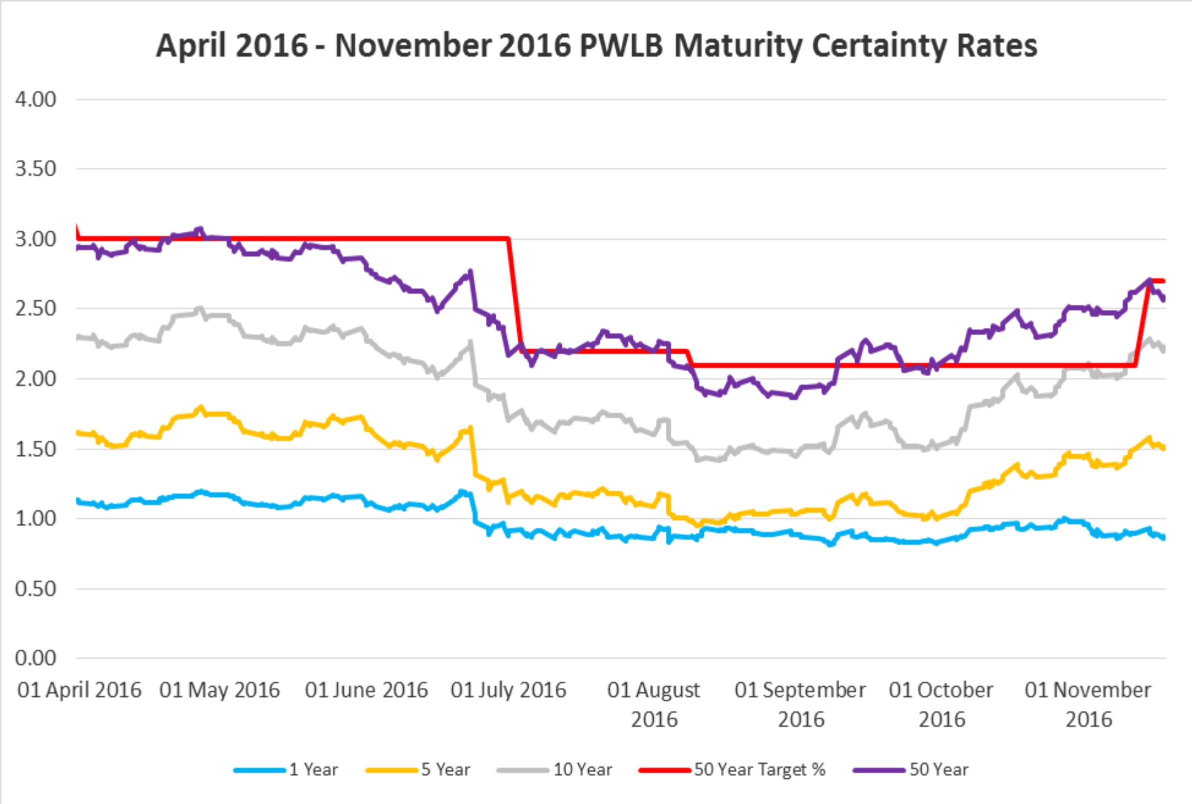
- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

.10 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, and information on any external support for banks to help support its decision making process.

7. BORROWING

7.1 The Council's capital financing requirement (CFR) at 31 March 2016 is £189.253m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the Public Works Loan Board or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

7.2 The Council had an outstanding borrowing requirement of £68.931m at 31 March 2016 which is estimated to increase to £94.325m at 31 March 2017. This outstanding borrowing requirement has been funded from internal balances on a temporary basis and has the impact of reducing the level of the Council's investment balances. This continues to be a prudent and cost effective approach in the current economic climate.



7.3 The table above shows the movement in Public Works Loan Board borrowing rates for the year to date. No borrowing has been taken up in year from the Public Works Loan Board or financial institutions.

7.4 The Council may take up some of the outstanding borrowing requirement in the second half of the year, should an opportune moment occur. All borrowing decisions will be taken in consultation with the Council's treasury management advisors.

8. MINIMUM REVENUE PROVISION

8.1 The amount of long-term debt that the Council may have is governed by the Prudential Limits set by the Council at the start of the financial year. This is based on the amount of borrowing which the Council has deemed to be prudent. It also allows for advance borrowing for future years' capital expenditure.

8.2 The Council must also allow for repayment of the debt, by way of the Minimum Revenue Provision (MRP). This is the minimum amount that the Council must set aside annually. The Local Authority (Capital Finance and Accounting) Regulations 2008 revised the previous detailed regulations and introduced a duty that an authority calculates an amount of MRP which it considered prudent, although the 2008 Regulations do not define "prudent provision", they provide guidance to authorities on how they should interpret this.

8.3 In 2015/16 the Council's MRP policy was revised from the previous practice (4% of the capital finance requirement on a reducing balance basis) to a straight line method of 2% of the 2015/16 capital financing requirement over a period of 50 years.

8.4 Any new prudential borrowing taken up will be provided for within the MRP calculation based upon the expected useful life of the asset or by an alternative approach deemed appropriate to the expenditure in question. This will continue to be reviewed on an ongoing basis.

8.5 For any finance leases and any on-balance sheet public finance initiative (PFI) schemes, the MRP charge will be equal to the principal repayment during the year, calculated in accordance with proper practices.

8.6 There will be no MRP charge for any cash backed Local Authority Mortgage Scheme (LAMS) that the Council operates. As for this type of scheme, any future debt liability would be met from the capital receipt arising from the deposit maturing after a 5 year period. Any repossession losses for this type of scheme would be charged to a LAMS reserve.

8.7 A review of the MRP policy will be undertaken as part of the 2017/18 strategy.

9. DEBT RESCHEDULING

9.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2016/17.

10. GREATER MANCHESTER METROPOLITAN DEBT ADMINISTRATION FUND (GMMDAF)

10.1 Unlike Tameside the GMMDAF incurs no capital expenditure, and therefore the total debt outstanding reduces annually by the amount of debt repaid by the constituent authorities. However, loans are raised to replace those maturing during the year, and for cashflow purposes.

10.2 At 31 March 2016 the fund had the following outstanding debt.

	£m
Public Works Loan Board	99.926
Other Balances	9.722
Total Debt	109.648

10.3 The fund's borrowing requirement for 2016/17 is estimated to be:-

	£m
Long term debt maturing	
Public Works loan Board	31.963
Other	0.041
	32.004
Less principal repayments	16.082
Deficit in year	(15.922)

10.4 The deficit in year is a result in timing differences between PWLB repayments and the principal repayments from the districts. The deficit will be covered by temporary borrowing taken up in year.

10.5 During 2016/17 it is estimated that the total interest payments will be £5.465m at an average interest rate of 5.09%. This compares with 5.30% in 2015/16.

10.6 No borrowing has been taken up in the first six months of 2016/17. However, loans may be taken up for either re-scheduling or borrowing early for future years, if prevailing rates are considered attractive.

11. RECOMMENDATIONS

11.1 As set out on the front of the report.