Chichester District Council

CABINET **6 October 2015**

Treasury Management 2014-15 Out-turn & 1st Quarter 2015/16 Monitoring

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2. Executive Summary

As required by the Chartered Institute of Public Finance (CIPFA), this report reviews the treasury management activity and Prudential Indicators out-turn for the financial year 2014-15.

The investment interest earned in the year amounted to £401,831 compared to the original estimate of £331,000 (revised to £413,280). Thus the actual return exceeded the original target but fell just short of the revised target.

The outturn equates to an average annual return of 0.87%, compared to the original target of 1.00%, and highlights the on-going impact of historically low interest rates and difficult market conditions within which this function operates. The Council's performance was slightly below the CIPFA benchmark of 1.19% for all participating local authorities.

As interest rates have not improved over the financial year, the increase in balances available for investing is the reason for the additional income received compared to the original estimate. The total investments held at 31 March 2015 amounted to £40.7m (£36.95m at 31 March 2014).

This report also includes at Appendix 3 the 1st quarter monitoring statement for 2015-16 for information purposes. This shows accrued interest in the period of £82,357, which equates to an average return on all investments of 0.69% compared to the target of 0.80%.

3. Recommendation

3.1 That Cabinet notes the treasury management outturn performance and the Prudential Indicators achieved for 2014-15 as set out in this report and Appendices 1 and 2.

3.2 That Cabinet notes the 1st Quarter Monitoring position statement for 2015-16 contained in Appendix 3.

4. Background

4.1 This report covers the treasury management activities and prudential indicators for 2014-15, as these must be considered by the same body of members who approved them as part of the Treasury Management Strategy prior to the start of the financial year. This then meets the requirements of both CIPFA's Treasury Management Code of Practice and the Prudential Code for Capital Finance in Local Authorities. The Council must comply with these Codes through Regulations issued under the Local Government Act 2003.

5. Outcomes to be achieved

5.1 This report is designed to demonstrate that the capital investment in the year meets the principles that the spending is prudent, affordable and sustainable, and that the treasury management activity is in accordance with the Council's Strategy for the year. The Cabinet approved the original 2014-15 prudential indicators on 4 February 2014.

5.2 This report summarises the 2014-15 performance:

(a) The capital activity for the year.

(b) How it was financed.

(c) Investment performance and benchmarking.

(d) The reporting of the required prudential indicators (Appendix 1).

6. The Council's Capital Expenditure and Financing 2014-15

6.1 Under the Prudential Code, the Council is required to have regard to the following:

- Affordability e.g. implications for Council Tax payers
- Prudence and sustainability e.g. implications for any external borrowing
- Treasury management decisions are taken in accordance with professional good practice.
- The authority remains accountable for decisions taken within a clear and transparent framework.

6.2 The actual capital spend in the year and how it was financed is shown in Appendix 1. This also shows the comparison of actual spend to the original and revised estimate.

6.3 The spend in the year on the approved projects, including the asset replacement programme, was £5.791m, of which £4.106m could be capitalised, as it met the statutory definition of capital expenditure. The balance of £1.685m was deemed revenue in nature and therefore was funded from either the revenue reserves or revenue grants and contributions, and has been reflected in the income and expenditure account.

6.4 The project spend of £5.791m was £3.755m less than the revised estimate of £9.546m due largely to:

i) a funding contribution (£1.1m) from the Homes and Communities Agency and other West Sussex local authorities towards the Gypsy & Travellers' Transit site

ii) the purchase of Woodruff Business Centre (£1.6m) on 2 April 2015 so that the expenditure slipped to 2015-16 where previously it was budgeted to be incurred in 2014-15;

iii) lower than expected payments in respect of: New Homes Bonus Scheme awards (£0.224m), Equity Loan Schemes (£0.159m) and beach management works (£0.120m)

iv) other net variations of £0.552m.

6.5 The total spend in the year was fully funded so there was no need to borrow, which is in accordance with the Council's strategy. However, the spend also included £146k in respect of multi-function devices acquired under new ways of working (NWOW). This acquisition has been treated as a credit agreement for which a Minimum Revenue Provision (MRP) of £23k was made to the 2014-15 accounts as part of the financing of the assets over 5 years.

7. Investment Performance 2014-15

7.1 CIPFA's Code of Practice and the Council's Treasury Management Strategy and Investment Guidelines were adhered to during the year. The total interest income for the year amounted to £401,831 (£407,228 in 2013-14), against an original estimate of £331,000, albeit the estimate was increased to £413,280 as part of the formulation of the 2014-15 Treasury Management Strategy in March 2015. The revision was made on account of higher surplus fund balances available for investment than was estimated at the start of the year, and therefore the expectation of increased investment income receivable.

7.2 The interest earned during the year continues to be against the background of very low interest rates and the restricted number of counter parties meeting the criteria under the strategy. The base rate remained at 0.5% and the investment portfolio was mainly kept short, except for a one year investment arranged in the year for £2m at a rate of 1.10%.

7.3 The investment performance at the end of quarter 4 for 2014-15, which has not previously been reported to Cabinet, is shown in Appendix 2. The rate of return achieved for the year was 0.87%, compared against the estimated interest rate of 1.00% in the Treasury Management Strategy.

7.4 Compared to the average Local Authority 7 Day rate of 0.35%, the actual return was 0.52% higher and equates to additional interest of £239,720 on average funds invested of £46.1m over 2014-15.

8. Investment Performance

8.1 The treasury management function was again involved in CIPFA's benchmarking exercise in respect of 2014-15, with 35 other local authorities taking part. The CIPFA benchmarking club also allows the Council to compare its performance against other local authorities that are selected by officers, who have similar characteristics to Chichester, e.g. debt free, and district councils rather than larger authorities. The results of the benchmarking are set out in the table below:

	CDC Return	Average (All)
Notice Accounts	0.57%	0.51%
Up to 30 days	0.38%	0.49%
Between 31 and 90 days	0.44%	0.54%
Between 91 and 364 days	0.55%	0.72%
Between 1 & 5 years	1.54%	1.59%
Callable & Structured	2.09%	2.19%
*DMADF (UK Government)	0.25%	0.25%
Combined (Overall)	0.87%	1.19%

* DMADF = Debt Management Account Deposit Facility (Investments placed with the Government)

8.2 The Council's combined overall performance of 0.87% fell short of the CIPFA benchmark of 1.19% for equivalent investments, albeit it exceeded the benchmark for Notice Accounts. Nevertheless, the results are a respectable achievement given the restrictive counterparty and market conditions under which treasury management has been operating whereby Base Rate has remained at 0.50% and the average 7 day LA Cash Rate at 0.35%.

8.3 The market rates applicable in the year were as follows:

Date	Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
Average	0.50		0.39	0.44	0.43	0.50	0.67	0.95	1.09	1.38	1.79
Maximum	0.50		0.50	0.62	0.43	0.51	0.81	1.00	1.38	1.77	2.26
Minimum	0.50		0.24	0.36	0.42	0.46	0.56	0.84	0.80	0.96	1.18
Spread	--		0.26	0.26	0.01	0.05	0.25	0.16	0.58	0.81	1.08

9. Economic Review

Growth and Inflation:

9.1 The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity.

9.2 Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in the oil price (which fell to $44.35 a barrel, a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor Mark Carney wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

Labour Market:

9.3 The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses.

UK Monetary Policy:

9.4 The Bank of England's MPC maintained interest rates at 0.5% and asset purchases (QE) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into response to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.

9.5 Political uncertainty had a large bearing on market confidence this year. The possibility of Scottish independence was of concern to the financial markets, but this dissipated following the outcome of September's referendum. The risk of upheaval (the pledge to devolve extensive new powers to the Scottish parliament; English MPs in turn demanding separate laws for England) lingers on. The highly politicised March Budget heralded the start of a closely contested general election campaign and markets braced for yet another hung parliament.

9.6 On the continent, the European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05% in September and the rate paid on commercial bank balances held with it was from -0.10% to -0.20%. The much-anticipated quantitative easing, which will expand the ECB's balance sheet by €1.1 trillion was finally announced by the central bank at its January meeting in an effort to steer the euro area away from deflation and invigorate its moribund economies. The size was at the high end of market expectations and it will involve buying €60bn of sovereign bonds, asset-backed securities and covered bonds a month commencing March 2015 through to September 2016. The possibility of a Greek exit from the Eurozone refused to subside given the clear frustrations that remained between its new government and its creditors.

9.7 The US economy rebounded strongly in 2014, employment growth was robust and there were early signs of wage pressures building, albeit from a low level. The Federal Reserve made no change to US policy rates. The central bank however continued with 'tapering', i.e. a reduction in asset purchases by $10 billion per month, and ended them altogether in October 2014. With the US economy resilient enough to weather the weakness of key trading partners and a strong US dollar, in March 2015 the Fed removed the word "patient" from its statement accompanying its rates decisions, effectively leaving the door open for a rise in rates later in the year.

Market reaction:

9.8 From July, gilt yields were driven lower by a combination of factors: geo-political risks emanating from the Middle East and Ukraine, the slide towards deflation within the Eurozone and the big slide in the price of oil and its transmission though into lower prices globally. 5-, 10- and 20-year gilt yields fell to their lows in January (0.88%, 1.33% and 1.86% respectively) before ending the year higher at 1.19%, 1.57% and 2.14% respectively.

10. Other Matters - Counterparty Update

10.1 The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. Taking the view that potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish, over 2014-15 Moody's revised the Outlook of several UK and EU banks from Stable to Negative (note, this is not the same as a rating review negative) and S&P placed the ratings of UK and German banks on Credit Watch with negative implications, following these countries' early adoption of the bail-in regime in the BRRD.

10.2 The Bank of England published its approach to bank resolution which gave an indication of how the reduction of a failing bank's liabilities might work in practice. The Bank of England will act if, in its opinion, a bank is failing, or is likely to fail, and there is not likely to be a successful private sector solution such as a takeover or share issue; a bank does not need to be technically insolvent (with liabilities exceeding assets) before regulatory intervention such as a bail-in takes place.

10.3 The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporates and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course.

10.4 In October, Arlingclose advised a reduction in investment duration limits for unsecured bank and building society investments to counter the risk of another full-blown Eurozone crisis. Durations for new unsecured investments with some UK institutions was further reduced to 100 days in February 2015.

10.5 In December the Bank's Prudential Regulation Authority (PRA) stress tested eight UK financial institutions to assess their resilience to a very severe housing market shock and to a sharp rise in interest rates and address the risks to the UK's financial stability. Institutions which 'passed' the tests but would be at risk in the event of a 'severe economic downturn' were Lloyds Banking Group and Royal Bank of Scotland. Lloyds Banking Group, [whose constituent banks are on the Authority's lending list], is taking measures to augment capital and the PRA does not require the group to submit a revised capital plan. RBS, which is not on the Authority's lending list for investments, has updated plans to issue additional Tier 1 capital. The Co-operative Bank failed the test.

11. Resources and Legal Implications

11.1 The investment income earned is used to help support the Council's capital programme. Any underperformance may have an impact on the Council's overall funding position, but this is kept under review and reported to members as part of the budget process. Currently the approved capital programme remains fully funded.

11.2 The Council has complied with all the relevant statutory and regulatory requirements that limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management, means that, its capital expenditure is prudent, affordable and sustainable, and demonstrates a low risk approach.

12. Other Implications

Crime & Disorder:	None
Climate Change:	None
Human Rights and Equality Impact:	None
Safeguarding:	None

13. Appendices

13.1 Appendix 1 – Capital expenditure out-turn 2014-15 and prudential indicators.

13.2 Appendix 2 – Treasury Management Activities 4th Quarter 2014-15

13.3 Appendix 3 – Treasury Management Activities 1st Quarter 2015-16

14. Background Papers

14.1 Treasury Management Strategy 2014-15.

14.2 CIPFA Benchmarking Draft Report for 2014-15 (contains exempt information under Paragraph 3 (information relating to the financial or business affairs of any particular person (including the authority holding that information) of Part I of Schedule 12A to the Local Government Act 1972.