Appendix C

2015/16 Treasury Management Progress Report
October to December 2015 (Quarter 3)

Report of Chief Officer (Resources)

1. Introduction

The CIPFA Code of Practice on Treasury Management requires that regular monitoring reports be presented to Members on treasury activities. These reports will normally be presented after the end of June, September, December and March as part of the Council's performance management framework.

Council approved the 2015/16 Treasury Strategy, which incorporates the Investment Strategy, at its meeting on 4 March 2015. This report outlines activities undertaken in pursuance of those strategies during the financial year up to the end of Qtr 3.

Treasury management is a technical area. To assist with the understanding of this report, a glossary of terms commonly used in Treasury Management is attached at ***Annex A***. In addition, the Councillor's Guide to Local Government Finance also has a section on treasury and cash management and an updated Guide is now available through the Member Information section on the Intranet.

2. Economic update (provided by Capital Asset Services)

During quarter 1 of 2015 the growth rate was weak at +0.4% though there was a slight increase in quarter 2 to +0.5% before falling back to +0.4% in quarter 3. Growth is expected to improve to about +0.6% in quarter 4 but the economy faces headwinds for exporters from the appreciation of Sterling against the Euro and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme, although the pace of reductions was eased in the November autumn statement.

Despite these headwinds, the Bank of England November Inflation Report included a forecast for growth over the three years of 2015, 2016 and 2017 to be around 2.7%, 2.5% and 2.6% respectively, although statistics since then would indicate that an actual outturn for 2015 is more likely to be around 2.2%. Nevertheless, this is still moderately strong growth which is being driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth.

The November Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon rejoin the world oil market after the impending lifting of sanctions, there could *be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.*

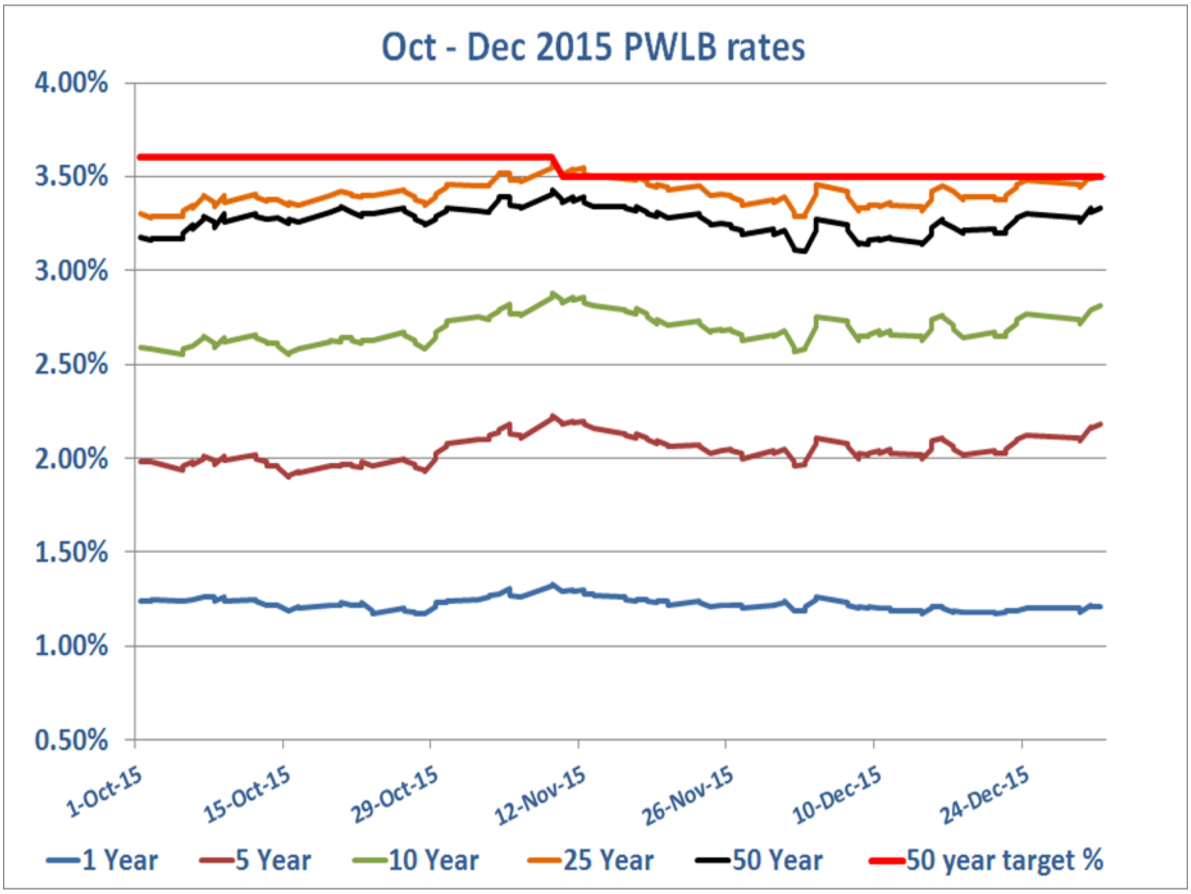
There are, therefore, considerable risks around whether inflation will rise in the near future as strongly as previously expected; this will make it more difficult for the Bank of England to make a start on raising Bank Rate as soon as had been expected in early 2015, especially given the subsequent major concerns around the slowdown in Chinese growth, the knock on impact on the earnings of emerging countries from falling oil and commodity prices, and the volatility we have seen in equity and bond markets during 2015, which could potentially spill over to impact the real economies rather than just financial markets.

The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015 before easing back to +2.0% in quarter 3. While there had been confident expectations during the summer that the Federal Bank could start increasing rates at its meeting on 17 September, downbeat news during the summer about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Bank's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were also disappointingly weak. However, since then concerns on both the domestic and international scene have abated and so the Bank made its long anticipated start in raising rates at its December meeting.

In the Eurozone (EZ), the European Central Bank (ECB) declared a massive €1.1 trillion programme of quantitative easing (QE) to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 but has then eased back to +0.4% in quarter 2 and to +0.3% in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

3. Borrowing Activities

No new borrowing was undertaken during Qtr3. The loan balance with the Public Works Loans Board (PWLB) at the end of September was £66.811M, and the annual cost of borrowing is £3.071M. The following graph shows the PWLB rates for the third quarter of this year.



Early Repayment of Debt
Officers continue to monitor potential saving opportunities associated with the early repayment of existing debt. This takes into account the premiums or discounts associated with early repayment and the projected cost of refinancing or loss in investment interest. At present, it would not be financially prudent to repay any debt based on the current rates being offered.

4. Investing Activities

As laid down in the approved Investment Strategy, the aim is to prioritise security and liquidity of the Council's investments. This is to ensure that the Council has sufficient cash to support its business, but also to minimise any further chance of a counterparty failing and the Council not being able to remove any cash deposited.

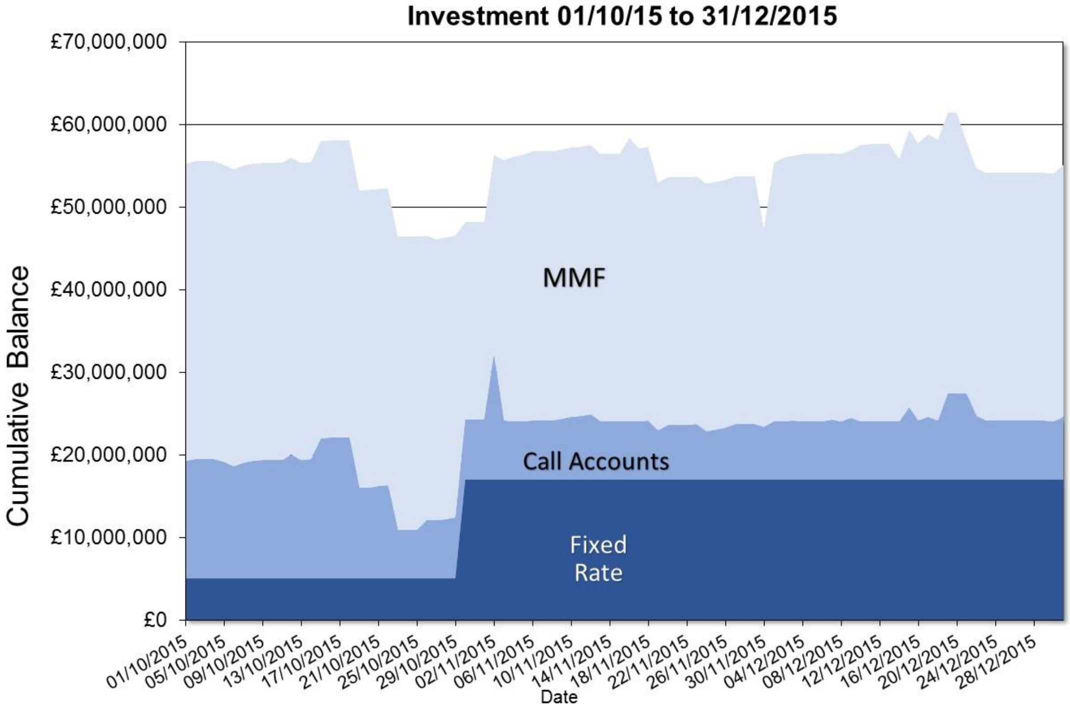
All investment activity has been in line with the approved Treasury Strategy for 2015/16. A summary of the investments at the end of Qtr 3 is shown in the following table (Table 6.1):

Table 6.1 Counterparty balances

Other Investments	Term	Maturity Date	Opening £	Min £	Max £	Closing £	Indicative Rate (YTD)	Current Fixed Rate	Interest for Q3 £	Cumulative Interest (YTD) £
Call Accounts										
Natwest (Cash Manager Plus)			7,307,200	10,470	9,991,833	633,428		0.25%	1,139	7,893
Lancashire County Council			0	0	5,000,000	0		0.25%	212	5,004
Santander			2,000,000	500,000	2,000,000	2,000,000		0.40%	1,840	5,500
Lloyds			0	0	0	0		0.40%	0	2,060
Notice Accounts										
Svenska Handelsbanken (35 day)			3,000,000	3,000,000	3,000,000	3,000,000	0.40%	0.45%	3,403	8,954
Money Market Funds										
Blackrock Government Liquidity			6,000,000	0	6,000,000	480,000	0.35%		2,636	13,081
Insight			6,000,000	0	6,000,000	6,000,000	0.40%		6,115	18,116
Blackrock Liquidity First			6,000,000	0	6,000,000	6,000,000	0.44%		6,674	19,929
Goldman Sachs			6,000,000	6,000,000	6,000,000	6,000,000	0.44%		6,659	10,336
LGIM			6,000,000	6,000,000	6,000,000	6,000,000	0.47%		7,099	7,876
Ignis			6,000,000	6,000,000	6,000,000	6,000,000	0.48%		7,484	21,885
Fixed Term Deposits										
Barclays	6 months	15/04/2016	2,000,000	2,000,000	2,000,000	2,000,000		0.64%	3,226	9,153
Lloyds	6 months	20/01/2016	2,000,000	2,000,000	2,000,000	2,000,000		0.70%	3,529	18,353
Birmingham City Council	6 months	29/04/2016	0	0	12,000,000	12,000,000		0.47%	9,735	9,735
Sub-total			52,307,200			52,113,428			59,751	157,876
								Budgeted income	42,459	120,513
										37,363

During the period, officers have placed an investment of £12M with Birmingham City Council (BCC) for 6 months at a rate of 0.47%. Investing with BCC offers a highly secure investment as it carries the same credit rating as the Government, and provided a return above those offered by MMFs and call accounts.

The Council continues to hold very high cash balances, caused primarily by the provision being held for repaying Business Rates transitional protection monies due back to the Government. The timing and mechanism for repayment is yet to be confirmed however, and so to manage this uncertainty the majority of the Council's balances are held in highly liquid MMFs and call accounts. The distribution of the Council's balances are displayed in the following graph:



Graph 6.1 Investment balances

Summary of Budget Position and Performance

In terms of performance against external benchmarks, the return on investments compared to the 7 day LIBID and bank rates over the year to date is as follows:

Base Rate	0.500%
7 day LIBID	0.360%
Lancaster City Council investments	0.405%

In terms of performance against budget, the details are as follows:

	Budget to Date £000's	Actuals to Date £000's	Variance £000's
Cash Interest	121	158	37
Total	**121**	**158**	**37**

Investment returns exceed the budgeted level by £37K. This is due to cash balances being larger than expected as a result of delays within the capital programme.

5. Risk management

The investment matrix, as approved by Council on 04 March, has increased the pool of counterparties that can be used and the term over which an investment can be placed, whilst still keeping risk appetite low. Given the very high cash balances being held currently, officers are keeping capacity under review, and have set up new MMFs and inter-authority investments as a result.

There is financial risk attached to the longer term debt portfolio (associated with interest rate exposure) as all of the debt is on fixed interest but there has been no change to this over the quarter. Low investment returns mean that using cash invested to repay debt can appear more attractive, however this is not a financially viable option at present due to the penalties associated with early repayment.

Annex A

Treasury Management Glossary of Terms

- **Annuity –** method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.

- **Call account** – instant access deposit account.

- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.

- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They analyse credit worthiness under four headings:

  - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.

  - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.

  - **Individual/Financial Strength Rating** – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.

  - **Legal Support Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

  The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO –** The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.

- **EIP –** Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.

- **Gilts** – the name given to bonds issued by the U K Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.
  E.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as 8%/1.45 = 5.5%.
  See also PWLB.

- **LIBID –** The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.

- **LIBOR –** The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.

- **Liquidity –** Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **Maturity –** Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.

- **Money Market Fund (MMF) –** Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status.

- **Nonfarm Payroll Employment** - is a compiled name for goods, construction and manufacturing companies in the US. It does not include farm workers, private household employees, or non-profit organization employees.

- **Policy and Strategy Documents –** documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.

- **Public Works Loans Board (PWLB) –** a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.

- **Capita Asset Services** – are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.

- **Yield –** see Gilts

Members may also wish to make reference to *The Councillor's Guide to Local Government Finance.*