

## Report to Council

# Treasury Management Half Year Review 2015/16

**Portfolio Holder:** Councillor Jabbar, Cabinet Member for Finance and HR

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**24<sup>th</sup> February 2016**

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## Reason for Decision

The report advises Council of the performance of the Treasury Management function of the Council for the first half of 2015/16, and provides a comparison of performance against the 2015/16 Treasury Management Strategy and Prudential Indicators.

## Executive Summary

The Council is required to consider the performance of the Treasury Management function in order to comply with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Revised Code of Practice. This report therefore sets out the key Treasury Management issues for Members' information and review and outlines:

- An economic update for the first six months of 2015/16;
- 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 2015/16;
- A review of the Council's borrowing strategy for 2015/16;
- Why there has been no debt rescheduling undertaken during 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

## **Recommendations**

Council is requested to approve the:

- Treasury Management activity for the first half of the financial year 2015/16 and the projected outturn position
- Amendments to both Authorised and Operational Boundary for external debt as set out in the table at Section 2.4.5 of the report.
- Changes to the credit methodology whereby viability, financial strength and support ratings will no longer be considered as key criteria in the choice of creditworthy investment counterparties.

**Treasury Management Strategy Statement and Annual Investment Strategy  
Mid-year Review Report 2015/16**

**1 Background**

- 1.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising 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 borrowing need of the Council, essentially the longer term cash flow planning 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, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 As a consequence 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. "
- 1.4 The Half Year Review report was presented for approval at the Cabinet meeting of 14 December. It was also subject to scrutiny at the Audit Committee meeting of 17 December.

**2 Current Position**

**2.1 Requirements of the Treasury Management Code of Practice**

- 2.1.1 The Council adopted the revised Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) on 23<sup>rd</sup> February 2011.
- 2.1.2 The primary requirements of the Code are as follows:
- a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities
  - b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives
  - c) 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

- d) 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. In Oldham, this responsibility is delegated to the Director of Finance.
- e) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. In Oldham, the delegated body is the Audit Committee.

2.1.3 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 2015/16;
- 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 2015/16;
- A review of the Council's borrowing strategy for 2015/16;
- Why there has been no debt rescheduling undertaken during 2015/16;
- A review of the compliance with Treasury and Prudential Limits for 2015/16;

## 2.2 **Economic Performance for the First Six Months of the Year**

2.2.1 The UK economy cannot be considered in isolation and the impact of the financial and economic performance of other countries and groups of countries has a significant influence on the global economic position as well as that of the UK. This section of the report therefore sets out key issues relating to the UK and other key regions and is relevant when considering performance for the first half of the 2015/16 financial year. Some of this information has subsequently been updated and more up to date economic performance data is therefore included in the 2016/17 Treasury Management Strategy Report.

### **The United Kingdom (UK) Economic and Financial Position**

2.2.2 UK Gross Domestic Product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, possibly being equal to that of the US. However, quarter 1 of 2015 was weak at +0.4% though there was a rebound in quarter 2 to +0.7%.

2.2.3 The Bank of England's August Inflation Report included a forecast for growth to remain around 2.4 to 2.8% over the next three years. However, the subsequent forward looking Purchasing Manager's Index (PMI) surveys in both September and early October for the services and manufacturing sectors showed a marked slow-down in the likely future overall rate of GDP growth to about +0.3%. This is not too surprising given the appreciation of Sterling against the Euro and weak growth in

the European Union (EU), China and emerging markets creating headwinds for UK exporters. Also, a fall in consumer confidence in September, due to an increase in concerns for the economic outlook, could also lead to a dampening of services sector growth through weakening consumer expenditure. For this recovery to become more balanced and sustainable in the longer term, the recovery still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure.

- 2.2.4 The strong growth since 2012 has resulted in unemployment falling quickly over the last few years although it has now picked up recently after the Chancellor announced in July significant increases planned in the minimum (living) wage over the course of this Parliament.
- 2.2.5 The Monetary Policy Committee (MPC) has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. It has therefore been encouraging in 2015 to see wage inflation rising significantly above Consumer Price Index (CPI) inflation which slipped back to zero in June and again in August
- 2.2.6 However, with the price of oil taking a fresh downward direction and Iran expected to soon re-join 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.
- 2.2.7 The August 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. Despite average weekly earnings picking up to 2.9% year on year in the three months ending in July (as announced in mid-September), this was unlikely to provide ammunition for the MPC to take action to raise the Bank Rate as soon as labour productivity growth meant that net labour unit costs appeared to be only rising by about 1% year on year. However, at the start of October, statistics came out announcing that annual labour cost growth had actually jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.
- 2.2.8 There are therefore considerable risks around whether inflation will rise in the near future as strongly and as quickly as previously expected; this will make it more difficult for the central banks of both the US and the UK to raise rates as soon as had previously been expected, especially given the recent 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 in 2015 so far, which could potentially spill over to impact the real economies rather than just financial markets.
- 2.2.9 On the other hand, there are also concerns around the fact that the central banks of the UK and US have few monetary policy options left to them given that central rates are near to zero and huge quantitative easing (QE) is already in place. There are therefore arguments that they need to raise rates sooner, rather than later, so they are prepared if there was a sudden second major financial crisis. But it is

hardly likely that they would raise rates until they are sure that growth was securely embedded and 'no-flation' was not a significant threat.

2.2.10 The forecast for the first increase in Bank Rate has therefore progressively been pushed back during 2015 from quarter 4 2015 to quarter 2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.2.11 The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

### **United States (US)**

2.2.12 GDP growth in 2014 of 2.4% was followed by first quarter 2015 growth depressed by exceptionally bad winter weather at only +0.6% (annualised). However, growth rebounded very strongly in quarter 2 to 3.9% (annualised) and strong growth was initially expected going forward.

2.2.13 Until the turmoil in financial markets in August caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Federal Reserve (Fed) would start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, and due to a 20% appreciation of the dollar which has caused the Fed to lower its growth forecasts. Since then the nonfarm payrolls figures for September and revised August, issued on 2 October 2015, were disappointingly weak and confirmed concerns that US growth is likely to significantly weaken. This has pushed back expectations of the first rate increase from 2015 into 2016.

### **Eurozone (EZ)**

2.2.14 The European Central Bank (ECB) announced a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme started in March and will run to September 2016. This seems to have already had a beneficial impact in improving confidence and sentiment.

2.2.15 There has also been a continuing trend of marginal increases in the GDP growth rate which hit 0.4% in quarter 1 2015 (1.0% year on year) and +0.4%, (1.5% year on year) in quarter 2 GDP.

2.2.16 The ECB has also stated it would extend its QE programme if inflation failed to return to its target of 2% within this initial time period.

### **Greece**

2.2.17 During July, Greece finally acceded to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance to EU demands of the Syriza Government, elected in January.

2.2.18 The subsequent surprise general election in September gave the Syriza Government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

### **China and Japan**

2.2.19 Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth. In quarter 2 2015 growth was down 1.6% (annualised) after a short burst of strong growth of 4.5% in quarter 1.

2.2.20 During 2015, Japan has been hit hard by the downturn in China. This does not bode well for Japan as the Government has already tried its first two options to try to stimulate recovery and a rise in inflation from near zero, but has withheld introducing the third, deregulation of protected and inefficient areas of the economy, due to political lobbies which have traditionally been supporters of the governing party.

2.2.21 As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market. Many commentators are concerned that recent growth figures around that figure could have been massaged to hide a downturn to a lower growth figure.

2.2.22 There are also major concerns as to the creditworthiness of much bank lending to corporates and local government during the post 2008 credit expansion period and whether the bursting of a bubble in housing prices is drawing nearer.

2.2.23 Overall, China is still expected to achieve a growth figure that the EU would envy. However, concerns about whether the Chinese cooling of the economy could be heading for a hard landing, and the volatility of the Chinese stock market, have caused major volatility in financial markets in August and September such that confidence is, at best, fragile.

### **Emerging Countries**

2.2.24 There are considerable concerns about the vulnerability of some emerging countries and their corporates. Since the financial crisis western investors have invested in emerging countries as they searched for yield by channelling investment cash away from western economies with poor growth, depressed bond yields (due to QE), and near zero interest rates. There is now a strong current flowing to reverse that flow, with a movement back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

2.2.25 This change in investors' strategy and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US and UK, has helped to cause the dollar and sterling to appreciate. In turn, this has made it much more costly for

emerging countries to service their western currency denominated debt at a time when their earnings from commodities are depressed.

2.2.26 There are also going to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates, if available at all.

2.2.27 Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by sovereign wealth funds of countries highly exposed to falls in commodity prices which, therefore, may have to liquidate investments in order to cover national budget deficits.

### 2.3 Interest Rate Forecast

2.3.1 The Council's treasury advisor, Capita Asset Services, has provided the following bank rate and Public Works Loan Board (PWLB) interest rate forecast covering the period from the last quarter of 2015 to the third quarter of 2018. Some of this information has subsequently been updated and more up to date interest rate forecasts are therefore included in the 2016/17 Treasury Management Strategy Report.

#### Interest Rate Forecasts for the period ending 31/12/15 to 31/6/18

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
5yr PWLB rate	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
50yr PWLB rate	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

2.3.2 Capita Asset Services undertook its last review of interest rate forecasts on 11 August shortly after the quarterly Bank of England Inflation Report. Later in August, fears around the slowdown in China and Japan caused major volatility in equities and bonds and sparked a flight from equities into safe havens like gilts and so caused PWLB rates to fall below the above forecasts for quarter 4 2015. However, there is much volatility in rates as news ebbs and flows in negative or positive ways and news in September in respect of Volkswagen, and other corporates, has compounded downward pressure on equity prices. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

2.3.3 Despite market turbulence in late August, and then September, causing a sharp downturn in PWLB rates, the overall trend in the longer term will be for gilt yields



and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

2.3.4 The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

2.3.5 The disappointing US nonfarm payrolls figures and UK PMI services figures at the beginning of October have served to reinforce a trend of increasing concerns that growth is likely to be significantly weaker than had previously been expected. This, therefore, has markedly increased concerns, both in the US and UK, that growth is only being achieved by monetary policy being highly aggressive with central rates at near zero and huge QE in place. This, in turn, is causing an increasing debate as to how realistic it will be for central banks to start on reversing such aggressive monetary policy until such time as strong growth rates are more firmly established and confidence increases that inflation is going to get back to around 2% within a 2-3 year time horizon. Market expectations in October for the first Bank Rate increase have therefore shifted back sharply as far as November 2016.

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.
- The commencement by the US Federal Reserve 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.

## **2.4 Treasury Management Strategy Statement and Annual Investment Strategy Update**

2.4.1 The Treasury Management Strategy Statement (TMSS) for 2015/16 was approved by Oldham Council on 25<sup>th</sup> February 2015. The underlying TMSS approved previously now requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out in the next sections of this report.

2.4.2 A decrease to both the overall Authorised Limit (the “affordable borrowing limit” required by Section 3 of the Local Government Act 2003 above which the Council does not have the power to borrow) and Operational Boundary (the expected borrowing position of the Council during the year) for external debt is required. This indicator is made up of external borrowing and other long term liabilities, Private Finance Initiatives (PFI) and Finance Leases. The revision to the limits aligns to the reduction in the Capital Financing Requirement (£18.451m) as outlined at paragraph 2.4.4 below.

2.4.3 The Council has the following Private Finance Initiative (PFI) and Public Private Partnership (PPP) Schemes each contributing to the Other Long Term Liabilities element of the Authorised Limit and the Operational Boundary::

- Gallery Oldham and Library
- Sheltered Housing (PFI2)
- Radclyffe and Failsworth Secondary Schools
- Chadderton Health & Well Being Centre
- Street Lighting
- Housing (PFI4)
- Blessed John Henry Newman RC College (Building Schools for the Future)

2.4.4 In addition, it will be necessary to decrease the Capital Financing Requirement (CFR) by £18.451m. Approved capital expenditure/ funding carry forwards from 2014/15 (£26.593m) caused an initial increase, however this is more than offset by estimated slippage and other anticipated adjustments in the 2015/16 capital programme resulting in the reduced CFR.

2.4.5 Members are therefore requested to approve the key changes to the 2015/16 prudential indicators as set out in the table below which show the original and recommended figures:

Prudential Indicator 2015/16	Original £'000	Recommended £'000
Authorised Limit	630,000	600,000
Operational Boundary	600,000	570,000
Capital Financing Requirement	572,382	553,931

## 2.5 The Council's Capital Position (Prudential Indicators)

2.5.1 This section of the report presents the Council's capital expenditure plans and their financing, the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow together with compliance with the limits in place for borrowing activity.

### Prudential Indicator for Capital Expenditure

2.5.2 The table below shows the half year position and the revised budget for capital expenditure (as per table 3 of the month 6 Capital Investment Programme monitoring report which was approved at Cabinet on 30<sup>th</sup> November 2015). It therefore highlights the changes that have taken place and are forecast since the capital programme was agreed at the Council meeting on 25 February 2015.

Capital Expenditure by Service	2015/16 Original Estimate  £'000	2015/16 Original Estimate Reconfigured Portfolios  £'000	2015/16 Revised Budget  £'000
Neighbourhoods	7,812		
Commissioning	1,950		
Commercial Services	19,058		
Development and Infrastructure	61,825		
Cooperatives and Neighbourhoods		6,999	15,144
Corporate and Commercial Services		2,407	4,126
Economy and Skills		79,289	63,729
Health and Wellbeing		1,950	1,788
Funds yet to be allocated			8
<b>General Fund Services</b>	<b>90,645</b>	<b>90,645</b>	<b>84,795</b>
HRA	0	0	416
<b>Total</b>	<b>90,645</b>	<b>90,645</b>	<b>85,211</b>

2.5.3 The above table shows a decrease in the capital programme of £5.434m to the month 6 position of £85.211m. The original estimate was initially increased by slippage of £26.593m brought forward into the 2015/16 programme from the previous year; this has

been offset by slippage in 2015/16, deletions and other movements showing a net decrease in the programme of £32.027m in the first 6 months of the year.

#### Changes to the Financing of the Capital Programme

- 2.5.4 The table below draws together the main strategy elements of the capital expenditure plans (above) highlighting the original supported (£35.180m) and unsupported elements i.e. requiring borrowing (£55.464m) of the capital programme, and the expected financing (revised position) arrangements of this capital expenditure. The borrowing need element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.
- 2.5.5 The overall net reduction in the capital programme has resulted in a change in the mix of funding sources required in 2015/16, a reduced reliance on capital receipts and prudential borrowing is offset by an increase in grant income and to a lesser extent an increased contribution from revenue.

<b>Capital Expenditure</b>	<b>2015/16 Original Estimate £'000</b>	<b>2015/16 Revised position £'000</b>
General Fund Services	90,644	84,795
HRA	0	416
<b>Total spend</b>	<b>90,644</b>	<b>85,211</b>
Supported Finance		
- Capital receipts	(14,554)	(9,245)
- Capital grants	(20,026)	(31,979)
- Revenue	(600)	(1,411)
<b>Total Supported financing</b>	<b>(35,180)</b>	<b>(42,635)</b>
<b>Borrowing need (Unsupported Finance)</b>	<b>55,464</b>	<b>42,576</b>

#### Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

- 2.5.6 The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. As previously mentioned in paragraph 2.4.4 the CFR needs to decrease by £18.451m. It also shows the expected debt position over the period (the Operational Boundary). This indicator has decreased to reflect the revisions to the forecast year end position of the capital programme.

	2015/16 Original Estimate £'000	2015/16 Revised Estimate £'000
<b>Prudential Indicator – Capital Financing Requirement</b>		
CFR – non housing	572,382	553,931
<b>Total CFR</b>	<b>572,382</b>	<b>553,931</b>
<b>Net movement in CFR</b>		<b>(18,451)</b>
<b>Prudential Indicator – External Debt / the Operational Boundary</b>		
Borrowing	325,000	295,000
Other long term liabilities*	275,000	275,000
<b>Total debt 31 March</b>	<b>600,000</b>	<b>570,000</b>

\* - On balance sheet PFI schemes and finance leases etc.  
Limits to Borrowing Activity

2.5.7 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose.

2.5.8 Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

2.5.9 The CFR calculation is shown in the table below and the Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

	2015/16 Original Estimate £'000	2015/16 Revised Estimate £'000
Gross borrowing	216,117	184,916
Plus other long term liabilities*	266,140	266,141
Gross borrowing	482,257	451,057
CFR* (year end position)	572,382	553,931

\* - Includes on balance sheet PFI schemes and finance leases etc.

2.5.10 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and

needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2015/16 Original Indicator	2015/16 Revised Indicator
Borrowing	345,000	315,000
Other long term liabilities*	285,000	285,000
<b>Total</b>	<b>630,000</b>	<b>600,000</b>

\* - Includes on balance sheet PFI schemes and finance leases etc.

#### Investment Portfolio 2015/16

2.5.11 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 2.3, 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 0.5% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and shorter term strategy. Given this risk environment, investment returns are likely to remain low.

2.5.12 The Council held £105.610m of investments, including property funds as at 30<sup>th</sup> September 2015 (£103.070m at 31 March 2015). A full list of investments as at 30<sup>th</sup> September 2015 is included in the table below.

2.5.13 Taking the opportunity to earn a better rate of return on its cash balances, the Council has in accordance with the approved TMSS, during the first 6 months of the current financial year tentatively started to use a broader range of investment products, namely Certificates of Deposit and Investment units with a Property Fund. To invest in these types of instruments, accounts have been opened up with a custodian service (King & Shaxson) and the Churches, Charities and Local Authority (CCLA) Property Fund.

2.5.14 Certificates of Deposit open up a wider range of approved counterparties, that the Council may either not have access to directly or who may not offer fixed investments. Although certificates of deposits are entered into for a fixed duration they can be sold on the secondary market in the highly unlikely event that there should be an urgent need for liquidity. As at 30<sup>th</sup> September £35m was held in Certificates of Deposit.

2.5.15 As mentioned above in 2.5.13, the Council has started to invest with CCLA Property Fund. Details are included within the table below. Further information regarding property funds can be found in paragraphs 2.5.26 – 2.5.29. At 30<sup>th</sup> September the investment had been held for 3 months and generated a return of 4.93%.

2.5.16 The Council ensures enough funds are kept in either instant access accounts and/ or on-call accounts to meet its short term liquidity requirements. As at 30<sup>th</sup> September the Council held £32.610m in such accounts.

Investments Counterparty	Type	30 Sept. 2015 £'000	Interest Rate	Date of Investment	Date of Maturity
CCLA Property Fund	Property	2,000	4.93%	30/06/15	Open
<b>Total Property Funds</b>		<b>2,000</b>			
Greater London Authority	Fixed	5,000	0.90%	15/04/14	15/10/15
Bank of Scotland plc	Fixed	3,000	0.80%	09/02/15	09/11/15
Barclays Bank plc	Fixed	5,000	0.78%	26/02/15	26/11/15
Barclays Bank plc	Fixed	5,000	0.92%	23/03/15	21/03/16
Nationwide Building Society	Fixed	2,500	0.66%	14/04/15	14/10/15
Bank of Scotland plc	Fixed	5,000	0.70%	11/05/15	11/11/15
Santander UK plc	Fixed	2,500	0.67%	03/06/15	03/12/15
Nationwide Building Society	Fixed	5,000	0.66%	17/08/15	17/02/16
Barclays Bank plc	Fixed	3,000	0.85%	20/08/15	20/05/16
<b>Total Fixed Investments</b>		<b>36,000</b>			
Standard Chartered Bank	CD	5,000	0.72%	20/04/15	20/10/15
Standard Chartered Bank	CD	2,500	0.90%	06/05/15	04/05/16
Royal Bank of Scotland plc	CD	5,000	0.91%	17/04/15	15/04/16
Royal Bank of Scotland plc	CD	5,000	0.72%	30/04/15	29/01/16
Sumitomo Mitsui Bank*	CD	2,000	0.57%	01/07/15	01/10/15
Abbey National Treasury Services	CD	5,000	0.73%	19/05/15	19/11/15
Standard Chartered Bank	CD	2,500	0.82%	19/05/15	19/02/16
Royal Bank of Scotland plc	CD	5,000	0.77%	20/05/15	19/02/16
Royal Bank of Scotland plc	CD	3,000	0.95%	14/07/15	12/07/16
<b>Total Certificates of Deposit</b>		<b>35,000</b>			
Bank of Scotland plc**	32 day call	2,000	0.57%	21/08/15	
<b>Total on call</b>		<b>2,000</b>			
SLI Sterling Liquidity/CI 2**	MMF	15,950	0.49%	01/03/15	01/10/15
Federated Prime Rate Sterling Liquidity 3**	MMF	7,660	0.48%	27/03/15	01/10/15
<b>Total Money Market Funds</b>		<b>30,610</b>			
<b>Total</b>		<b>105,610</b>			

\* Sumitomo Mitsui Banking Corporation Europe - UK Bank; Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority

\*\* denotes instant access/ on call investments

2.5.17 The Council's investment strategy looks to achieve a return on its investment of London Interbank Bid Rate (LIBID) plus a 5% mark up. The Council will maintain sufficient cash reserves to give it its necessary liquidity and may place investments up to 5 years if the cash flow forecast allows and the credit rating criteria is met. Performance against this benchmark was as follows:

Average 7 Day LIBID	0.36175%
Benchmark	0.37984%
Average 3 month LIBID	0.45813%
Benchmark	0.48104%
Average Return on all cash investments made	0.66159%

2.5.18 The Council's overall average performance on its cash investments exceeded its target by 0.28176% on 7 day LIBID and 0.18056% on 3 month LIBID, the performance against the relevant LIBID/ strategy benchmark, matched to the length of investment is further analysed at appendix 2.

2.5.19 The cash investments have generated £0.347m of income in the first 6 months of the financial year. Furthermore The Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2015/16.

#### Investment Counterparty Criteria

2.5.20 The Council currently has investment criteria and limits and these are set out in the table below. This shows the colour banding into which each of the counterparties are categorised, depending on their credit rating, and for each colour banding, the maximum duration of the investment and the maximum principal that can be invested. The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

Capital Colour Band	Maximum Duration	Maximum Principal Invested £
Yellow (Note 1)	5 Years	£10m
Dark Pink (Note 2)	5 Years	£10m
Light Pink (Note 3)	5 Years	£10m
Purple	2 Years	£20m
Blue (Note 4)	1 Year	£20m
Orange (Note 5)	1 Year	£15m
Red	6 months	£10m
Green	100 days	£10m
No Colour	Not to be used	Not to be used

Note 1 – Includes Public Sector Bodies

Note 2 – Enhanced money market funds (EMMF) with a credit score of 1.25



Note 3 - Enhanced money market funds (EMMF) with a credit score of 1.5

Note 4 – Blue Institutions only applies to nationalised or semi nationalised UK Banks, which are currently:

- Lloyds Banking Group – Lloyds and Bank of Scotland.
- RBS Group – Royal Bank of Scotland, Natwest Bank and Ulster Bank.

Note 5 - Includes the Council's banking provider, if it currently falls into category below this colour band.

2.5.21 The Council has re-appointed Capita Asset Services as its Treasury Advisors (see 2.9 below) and uses its rating assessments to support investment decisions. Capita is changing its credit rating methodology and this impacts on the Councils own assessment methodology. This change is outlined in the following paragraphs.

#### Change in Credit Rating Methodologies

2.5.22 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of the new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

2.5.23 In keeping with the agencies' new methodologies, the credit element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used by Standard & Poor's, this has been a change to the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed

2.5.24 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While the Council understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AAA for all non-UK countries. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

2.5.25 It is important to note that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution, merely a reassessment of their methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the “support” phase of the financial crisis.

#### Property Funds

2.5.26 As highlighted in sections 2.5.12 and 2.5.15, during 2015/16 the Council has invested in the CCLA (Churches, Charities & Local Authority) Property Fund. The fund is a unit trust fund that invests in commercial and industrial property in the UK. This is a longer term investment and it is recommended to hold the units for at least 3 years.

2.5.27 Prior to use guidance was sought regarding the status of this fund. The CCLA fund has been approved by HM Treasury under section 11(1) of the Trustee Investments Act 1961, and in accordance with section 25(3)(d) of the regulations, the purchase of units in this Fund does not count as capital expenditure in England. It will be accounted for as an available for sale financial asset. Due diligence was also carried out prior to use in terms of organisation background, property portfolio, past performance, use by other Authorities within the sector and employee expertise.

2.5.28 The fund is performing well and is currently yielding 4.93% for the 3 month period ending September 2015.

2.5.29 In the future it is possible that the Council may choose to use other property funds. If this were to be the case it will seek prior advice regarding the status of any new fund, undertake thorough and appropriate due diligence and seek advice in terms of accounting treatment (the use of these instruments can be deemed capital expenditure, and as such would therefore be an application of capital resources and appear in the capital programme).

#### Bonds

2.5.30 The current TMSS gives theoretical approval to the use of bonds as an alternative investment instrument, the Authority does not currently hold any such investments, it is however aware of the emerging popularity of Bonds within the sector and may consider investing in bonds in the current financial year, consideration would therefore be required as to the type/ category of bond e.g. corporate, government, financial institution, the rating of the issuer and the maturity duration before any such decision was made.

## 2.6 Borrowing

### PWLB

- 2.6.1 It is proposed in this report that the Council's CFR for 2015/16 is revised to £553.931m and this denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB 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.
- 2.6.2 The table within paragraph 2.5.9 shows the Council has borrowings of £451.057m and has utilised £102.874m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.
- 2.6.3 The Council has not undertaken any borrowing in the first half of the year, and did not undertake any debt rescheduling during the first half of 2015/16.
- 2.6.4 As outlined below, the general trend has been an increase in interest rates during the first quarter but then a fall during the second quarter.
- 2.6.5 Current PWLB maturity rates are set out in the following table and show for a selection of maturity periods over the first half of 2015/16, the range (high and low points) in rates and the average rates over the period. In addition, Appendix 1 tracks the movement in the PWLB certainty rate over the period in question across the same range of loan terms as is used in the table below.

Maturity Rates	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/15	02/04/15	02/04/15	02/04/15	02/04/15
High	1.35%	2.35%	3.06%	3.66%	3.58%
Date	05/08/15	14/07/15	14/07/15	02/07/15	14/07/15
Average	1.26%	2.12%	2.76%	3.39%	3.29%

- 2.6.6 The Council will closely monitor the movement in PWLB interest rates and if available those being offered by the Municipal Bonds Agency (see 2.6.8 and 2.6.9 below) during the remaining months of the year. This will be considered in conjunction with the spend profile of the capital programme and borrowing may be undertaken to support the capital plans of the Council if this is considered advantageous.
- 2.6.7 Members may recall that for the last 3 years the Council has been able to take advantage of the PWLB certainty rate, whereby there is a 20 basis points discount on standard loans from the PWLB under the prudential borrowing regime for Authorities providing improved information on their long term borrowing and associated capital spending plans. The obvious benefit to the Council of the certainty rate will be reflected in the future with reduced Treasury Management borrowing costs in relation to any

PWLB borrowing undertaken. The Council has submitted its spending plans for 2015/16 and currently awaits conformation of extension of the certainty rate for the period 1<sup>st</sup> November 2015 to 31<sup>st</sup> October 2016. The certainty rate variations are shown in Appendix 1.

#### Municipal Bonds Agency (MBA)

2.6.8 The Local Government Association (LGA) is close to completing the setting up of the Municipal Bonds Agency (MBA) the aim of which is to seek to provide Councils with a cheaper source of long term borrowing and to introduce sector owned diversity into the Local Government lending market, the Council has invested a total sum of £0.100m in the equity of the MBA.

2.6.9 The Council has undertaken this investment to access a potentially cheaper source of long term borrowing and any other beneficial financing arrangements that may become available. The agency has indicated that the first bond could possibly be issued in the Spring of 2016, whilst this may not be the opportune timing for Oldham the Council will keep under review the availability and cost of funds from the MBA as an alternative source of finance with a view to borrowing at an appropriate time if terms are preferential. As an investor, the Council would expect to benefit from any profits generated by the MBA

#### 2.7 Overall Position at the Mid –Year 2015/16

2.7.1 The position at the mid-year 2015/16 shows that the Council is continuing to follow recommended practice and manage its treasury affairs in a prudent manner.

#### 2.8 Current Position- Banking

2.8.1 The Council has a banking contract in place with Barclays Bank effective from 1<sup>st</sup> April 2014 for a duration of 5 years. The working relationship between the parties is proving successful and it has enabled the Council to adopt a more traditional working relationship with its clearing bank.

#### 2.9 Treasury Management Advisors

2.9.1 The contract engaging Capita Asset Services as the Councils Treasury Management advisors expired on 31<sup>st</sup> March 2015, the Council undertook a competitive joint tendering exercise with other GM Local Government bodies to procure advisory services from April 2015, the outcome of which is that Capita Asset Services were re-appointed as Treasury Management advisors for a period of 3 years (with the option for a further year) effective from 1<sup>st</sup> April 2015.

### 3 Options/Alternatives

3.1 In order that the Council complies with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management the Council has no option other than to consider and approve the contents of the report. Therefore no options/alternatives have been presented.

#### **4 Preferred Option**

4.1 As stated above the preferred option is that the contents of the report are approved

#### **5 Consultation**

5.1 Consultation has taken place with Capita Asset Services (the Councils Treasury Management Advisors), and the Executive Management Team (EMT). The report was presented to the Audit Committee on 17<sup>th</sup> December 2015 and approved by Cabinet on 14<sup>th</sup> December 2015.

#### **6 Financial Implications**

6.1 All included in the report.

#### **7 Legal Services Comments**

7.1 None

#### **8 Cooperative Agenda**

8.1 The Council ensures that any Treasury Management decisions comply as far as possible with the ethos of the Cooperative Council.

#### **9 Human Resources Comments**

9.1 None

#### **10 Risk Assessments**

10.1 There are considerable risks to the security of the Authority's resources if appropriate treasury management strategies and policies are not adopted and followed. The Council has established good practice in relation to treasury management which have previously been acknowledged in the External Auditors' Annual Governance Report presented to the Audit Committee.

#### **11 IT Implications**

11.1 None

#### **12 Property Implications**

12.1 None

#### **13 Procurement Implications**

13.1 None

#### **14 Environmental and Health & Safety Implications**

14.1 None

15 **Equality, community cohesion and crime implications**

15.1 None

16 **Equality Impact Assessment Completed?**

16.1 No

17 **Key Decision**

17.1 Yes

18 **Forward Plan Reference**

18.1 CFHR -22-15

19 **Background Papers**

19.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref:	Background papers are contained within Appendices 1 and 2.
Officer Name:	Anne Ryans
Contact No:	0161 770 4902

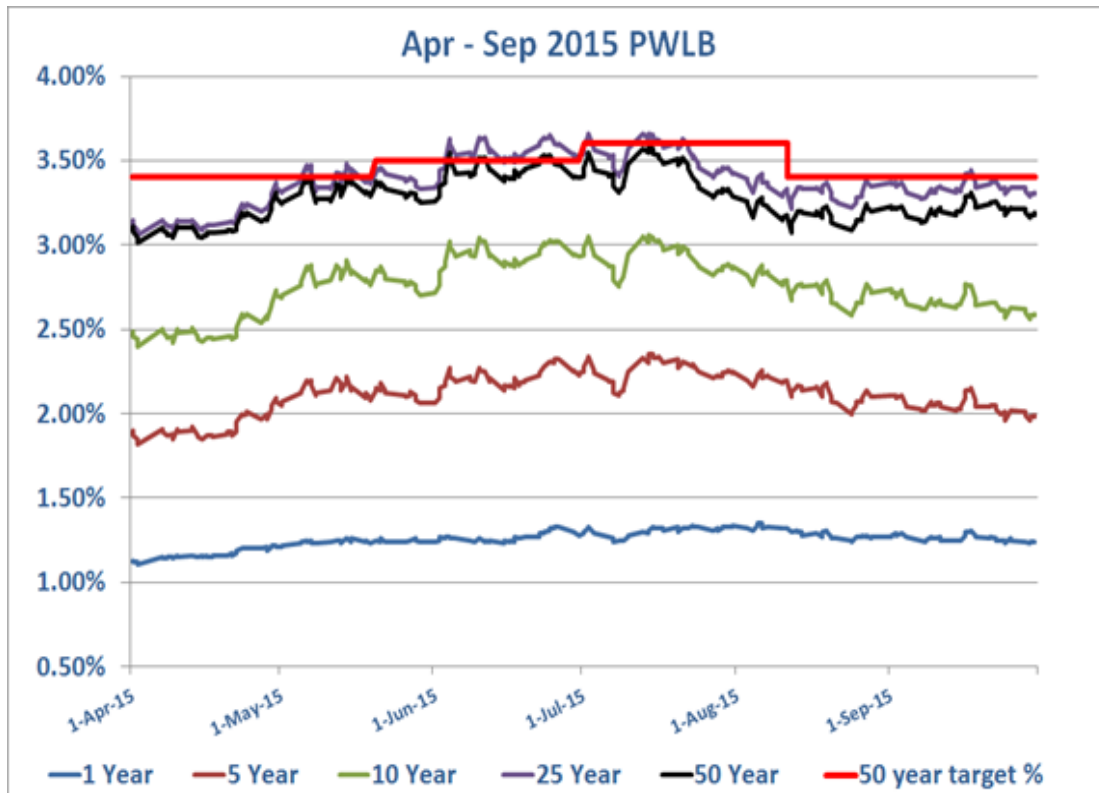
20 **Appendices**

20.1 Appendix 1 – Borrowing

Appendix 2 – Investments

## APPENDIX 1- Borrowing

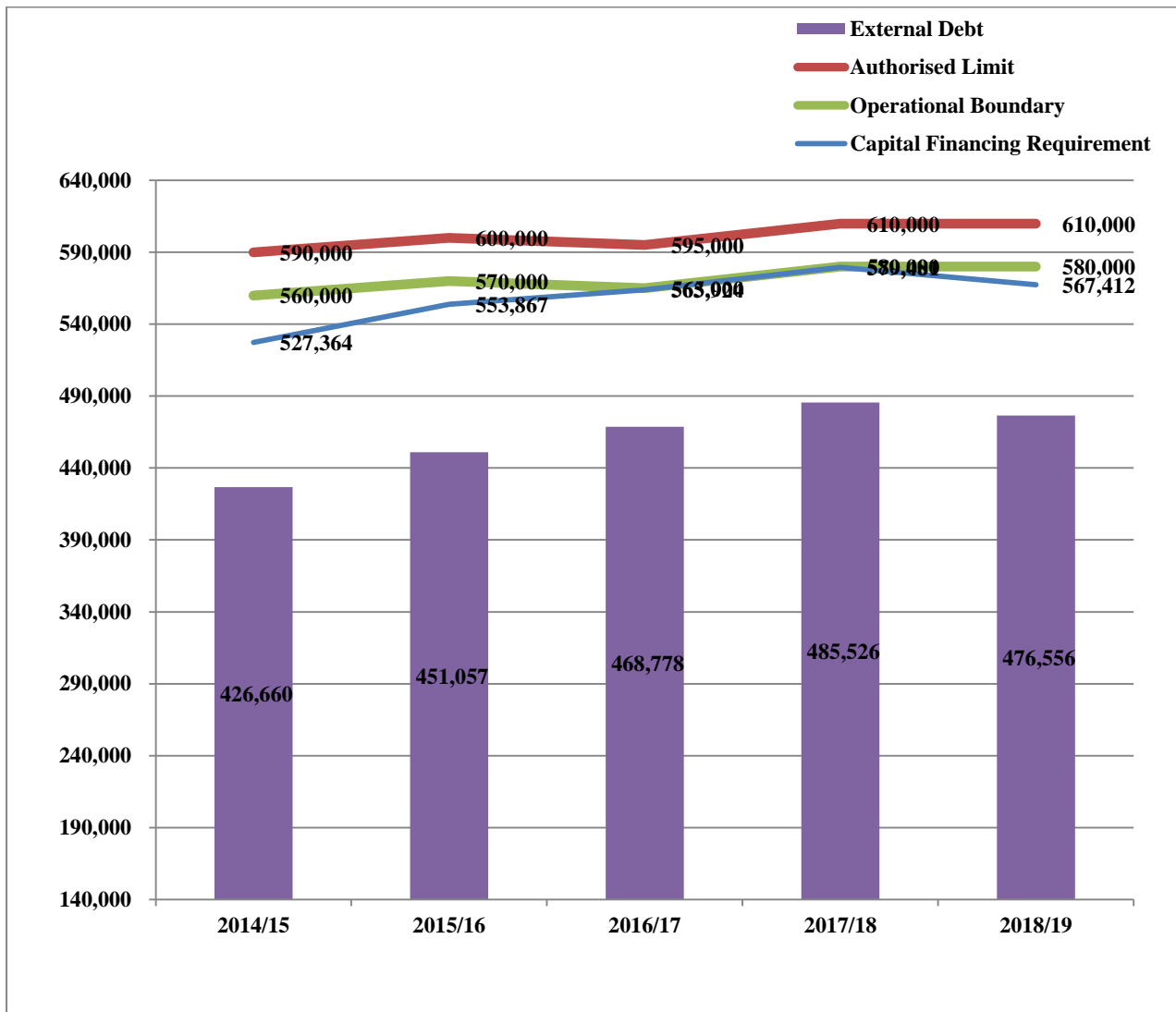
### 1A) PWLB Certainty Rate Variations 2015/16



### 1B) Comparison of borrowing parameters to actual external borrowing (Table)

Actual/Expected	2014/15 £'000	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000
Authorised Limit	590,000	600,000	595,000	610,000	610,000
Operational Boundary	560,000	570,000	565,000	580,000	580,000
Capital Financing Requirement	527,364	553,931	563,924	579,481	567,412
External Debt	426,660	451,057	468,775	485,523	476,553

**1C) Comparison of borrowing parameters to actual external borrowing (Graph)**





## Appendix 2

### 2A) Investment performance for half year to 30th September 2015

Benchmark	Benchmark Return LIBID	Council Performance	Investment Interest Earned
7 day *	0.38%	0.49%	£79,376
1 month	0.38%	0.57%	£1,312
3 month *	0.48%	0.52%	£31,060
6 month	0.60%	0.73%	£153,544
12 month	0.90%	0.91%	£81,221

\*includes 5% mark up as per 15/16 strategy performance target

### 2B) Comparison of Bank rate against LIBID (various) April to September 2015

