BARNSLEY METROPOLITAN BOROUGH COUNCIL

This matter is not a Key Decision within the Council's definition and has not been included in the relevant Forward Plan

Report of the Director of Finance, Assets and Information Services

TREASURY MANAGEMENT ACTVITIES & INVESTMENT PERFORMANCE - QUARTER ENDING 30 JUNE 2015

1. Purpose of the Report

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

2. Recommendations

2.1 It is recommended that Members note:-

- **the Treasury Management activities undertaken for the period and compliance with the Prudential Indicators;**
- **the Authority's Capital Programme Funding Position;**
- **the performance of the Authority's investments for the reported quarter.**

3. Economic Summary

3.1 After strong UK GDP growth in 2013 and 2014, the economic recovery slowed in the first quarter of 2015/16. Wage growth picked up as the labour market tightened and the latest consumer confidence figures suggest that households still think now is a good time to undertake major purchases.

3.2 There was another split vote by the Bank of England's Monetary Policy Committee (MPC), but an increase in interest rates before the end of the year remains unlikely.

3.3 With the Conservatives winning an outright majority in May's general election, the fiscal squeeze is set to re-intensify next year. In order to meet their manifesto pledge, the Conservatives will have to implement a fiscal consolidation of around 5% of GDP over the next four years; which will have to come through cuts to spending given that they have pledged not to increase VAT, income tax or national insurance.

3.4 The possibility of a Greek exit from the Eurozone became greater during the first quarter. Whilst the UK's direct exposures to Greece are small, there could be an adverse impact on the UK economy due to general financial market instability.

3.5 A detailed economic commentary on developments during quarter ended 30th June 2015 is provided at Appendix 3.

4. Interest Rate Forecast

4.1 The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%

4.2 This latest forecast shows the timing of the first increase in Bank Rate will be quarter 1 of 2016 as a result primarily of poor growth, although there are signs that an increase could come earlier. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual, and the table above shows relatively small 0.25% rises over the next three years. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation.

4.3 A detailed commentary on interest rate forecasts is provided at Appendix 4.

5. Annual Investment Strategy

5.1 The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 11th February 2015. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

5.2 The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

5.3 The table below summarises the investment transactions undertaken during the period and officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2015. An analysis of the Authority's investment portfolio as at 30th June 2015 is provided at Appendix 2.

	Balance on 01/04/2015 £m	**Investments Made £m**	**Investments Repaid £m**	**Balance on 30/06/2015 £m**	**Increase/ (Decrease) in Investments for Q1 £m**
Long-Term Investments	5.000	4.000	-	9.000	4.000
Short-Term Investments	26.000	3.000	19.000	10.000	(16.000)
Money Market Funds / Instant Access	11.520	93.800	84.420	20.900	9.380
TOTAL INVESTMENTS	**42.520**	**100.800**	**103.420**	**39.900**	**(2.620)**

5.4 Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the current Bank Rate and other extraordinary measures such as the Funding for Lending Scheme (FLS), which has bolstered the economy by allowing commercial banks to borrow from the Bank of England cheaply, so that the banks then pass this on in the form of cheap loans to firms.

5.5 The 7 day London Interbank Bid Rate (LIBID) is used as a performance indicator for measuring the return on investments. The average 7 day LIBID for the 1st Quarter was 0.36%. The average rate of return on the Authority's total investments for the quarter exceeded the benchmark and was 0.54%.

6. The Authority's Capital Programme Funding Position

6.1 Borrowing transactions during the quarter are summarised in the table below:

	Balance on 01/04/2015 £m	Debt Repaid £m	New Borrowing £m	Balance on 30/06/2015£ m	Increase/ (Decrease) in Borrowing £m
Short Term Borrowing	53.503	30.500	18.000	41.003	(12.500)
PWLB Borrowing	428.189	1.148	-	427.042	(1.148)
Other Long Term Loans	63.500	-	-	63.500	-
TOTAL BORROWING	**545.192**	**31.648**	**18.000**	**531.545**	**(13.648)**

6.2 There was a decrease in external debt of £13.7M during the quarter consisting mainly of the repayment of temporary borrowing.

6.3 Short term borrowing levels decreased during the quarter in line with cash flows as a large proportion of grant funding is received during the early stages of the financial year. However, temporary borrowing continues to represent an inexpensive method of financing and will continue to form an integral part of the borrowing strategy for 2015-16 as stated in the Treasury Management Strategy. Affordability and the 'cost of carry' (the difference between long-term borrowing rates and short-term investment rates) remain important influences on the borrowing strategy and the Authority determines it cost effective in the short-term to use internal resources.

New Borrowing

6.4 The 25 year PWLB target (certainty) rate for new long term borrowing, for the quarter ending 30th June, rose slightly from 3.40% to 3.50% after the May Bank of England Inflation report. Due to the overall financial position no new long-term borrowing was undertaken during the quarter. The PWLB certainty rates for the quarter ended 30th June 2015 are shown in Appendix 4.

Borrowing in Advance of Need

6.5 The Council has not borrowed in advance of need during the quarter ended 30th June 2015.

7. Debt Rescheduling

7.1 Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. During the quarter ended 30th June 2015, no debt rescheduling was undertaken.

8. Compliance with Treasury and Prudential Limits

8.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS.

8.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 1.

9. Treasury Management Advisors

9.1 Following a tender process in June 2015, Capita Asset Services were awarded a three year contract for the provision of Treasury Management Services to the Authority, replacing the previous advisors, Arlingclose Ltd.

10. Review of TM Activities

10.1 As mentioned at Section 6, the Council is in an 'under borrowed' position (i.e. reflective of the amount it internally borrows) with further significant borrowing still required over the next 2-3 years in relation to town centre spend. Bearing in mind interest rates are expected to rise over the next 12-18 month period, the Council has over half of its borrowing requirement at risk of interest rate change and has a reserves strategy that plans to spend its available resources. As such, it is likely that the Council will not be able to sustain a temporary / internal borrowing position at current levels and will need to fix out some more borrowing in the near future. Financial Services will continue to closely monitor this position to ensure that its long term borrowing position is optimised without unduly incurring additional costs in the short term.

10.2 The Council also has a number of loans that will mature over the next 2-3 years at relatively high rates. Financial Services will again seek to replace these loans at lower rates as part of the process to optimise the Council's longer term borrowing position.

10.3 The Council is also looking at alternative investment options including property based funds and has already had protracted consultations with one property fund. The Council has also invested in the LGA's Municipal Fund bond which is seeking to offer cheap loan rates. This will allow the Council access to cheaper alternate rates compared to more traditional methods such as PWLB or market rates. However, the Council's main focus for securing savings will be twofold:

MRP Review

10.4 The first relates to reviewing it MRP policy. The Council has discretion to determine how it repays its loans and has previously taken a fairly prudent approach with repayments typically over 25 years. Our review will focus on the repayment periods we have in place to determine whether payments can be smoothed over a longer period – similar to re-mortgaging. Although repaying debt over a longer period will mean higher overall interest costs, the short to medium term costs (up to 10 years) will be much lower.

10.5 This is a complex area with a number of options and the Council's Treasury Management advisors will be consulted throughout the process to ensure that the rationale that is proposed is reasonable. In addition, the Council's external auditor will be consulted on the drafts of these proposals.

Review of BSF Financing

10.6 The other main focus will be refinancing the Council's BSF programme particularly in relation to debt currently incurred by the Local Education Partnership (LEP). This debt is recharged to the Council at rates higher than the Council is able to access itself.

10.7 We are therefore looking at whether the Council could fund this debt itself to facilitate cheaper repayments. We have already scoped this out with our treasury management advisers and because there were three phases of the BSF programme with different funders and terms, there are a number of permutations and complexities. The review will therefore seek to weigh up the more favourable terms and interest rates that the Council can offer against the penalty clauses associated with withdrawing early.

11. Benchmarking

11.1 The Council receives benchmarking information from Capita which compares investment performance against that of their other clients. This information has the added advantage of including risk weightings and allows comparison with other counterparties who are receiving the same investment advice.

11.2 Appendix 5 includes a quarterly investment benchmarking analysis graph to illustrate the Authority's position in terms of risk verses return. The graph shows we are currently outperforming our risk adjusted benchmark, by being just above the upper return level. Given the short-dated nature of our investment portfolio, we are at the lower end of the risk scale, with an average maturity of just seven days.

11.3 Officers will continue to measure and manage its exposure to treasury management risks by using benchmarking data and other performance indicators.

APPENDICES

1. Prudential and Treasury Indicators as at 30th June 2015
2. Analysis of Investment Portfolio as at 30th June 2015
3. Detailed Economic Commentary on Developments During Quarter Ended 30th June 2015
4. Detailed Commentary on Interest Rate Forecasts and Capita Asset Services' Forward View
5. Investment Benchmarking June 2015

Appendix 1

Prudential and Treasury Indicators as at 30th June 2015

Prudential Indicators	Limit for 2015/16 £'000	Actual at 30/06/2015 £'000	Compliance with Indicator
Maximum debt compared to Authorised Limit	965.000	800.150	Yes
Average debt compared to Operational Boundary	950.000	795.344	Yes

Maturity structure of fixed rate borrowing - upper and lower limits	Upper Limit (%)	Lower Limit (%)	Actual Fixed Borrowing 30/06/15 £'000	% Fixed Borrowing at 30/06/15	Compliance with Indicator
Under 12 months	50	0	103.801	23%	Yes
12 months to 2 years	25	0	14.328	3%	Yes
2 years to 5 years	25	0	36.174	8%	Yes
5 years to 10 years	25	0	50.932	11%	Yes
10 years to 20 years	75	0	36.476	8%	Yes
20 years to 30 years	75	0	0.500	1%	Yes
30 years to 40 years	75	0	82.400	18%	Yes
40 years to 50 years	75	0	126.030	28%	Yes

Prudential Indicators	Limit for 2015/16 (%)	Actual at 30/06/2015 (%)	Compliance with Indicator
Upper limit of fixed interest rates based on net debt	90%	90%	Yes
Upper limit of variable interest rates based on net debt	25%	10%	Yes

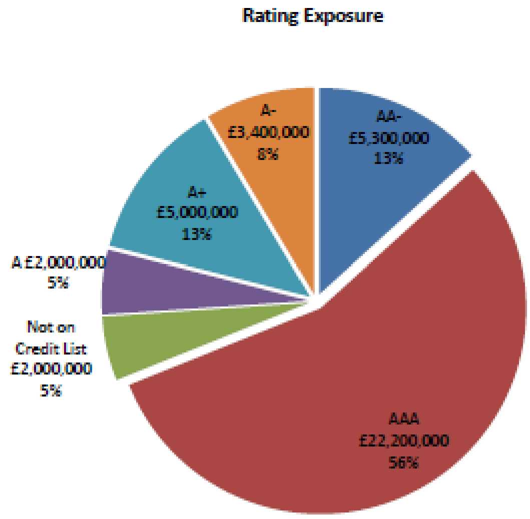
Prudential Indicators	Limit for 2015/16 £'000	Actual at 30/06/2015 £'000	Compliance with Indicator
Upper limit for principal sums invested over 364 days	20.000	0	Yes

Appendix 2

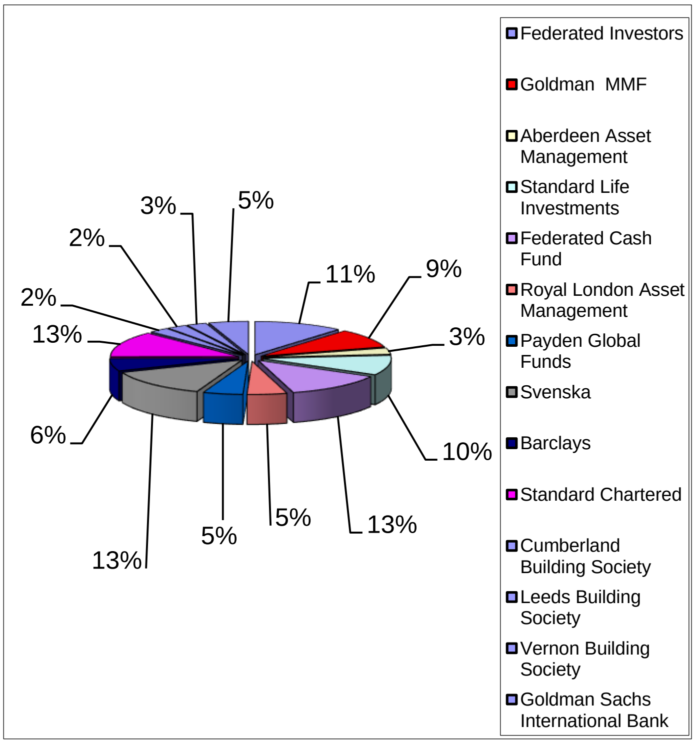
Analysis of Investment Portfolio as at 30th June 2015

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
MMF Federated Investors (UK)	4,500,000	0.46%		MMF	AAA	0.000%
MMF Aberdeen	1,200,000	0.36%		MMF	AAA	0.000%
MMF Goldman Sachs	3,700,000	0.41%		MMF	AAA	0.000%
MMF Standard Life	3,800,000	0.48%		MMF	AAA	0.000%
Barclays Bank Plc	2,400,000	0.50%		Call	A-	0.000%
Svenska Handelsbanken AB	5,300,000	0.45%		Call	AA-	0.000%
EMMF Federated Sterling Cash Plus Fund	5,000,000	0.71%		EMMF	AAA	0.000%
EMMF Royal London Asset Management Cash Plus	2,000,000	0.83%		EMMF	AAA	0.000%
EMMF Payden Sterling Reserve Fund	2,000,000	1.16%		EMMF	AAA	0.000%
Goldman Sachs International Bank	2,000,000	0.53%	15/04/2015	15/07/2015	A	0.003%
Standard Chartered Bank	5,000,000	0.64%	19/01/2015	20/07/2015	A+	0.003%
Cumberland Building Society	1,000,000	0.51%	05/05/2015	13/08/2015	Not on Credit List	
Leeds Building Society	1,000,000	0.44%	14/05/2015	21/08/2015	A-	0.009%
Vernon Building Society	1,000,000	0.55%	15/05/2015	21/08/2015	Not on Credit List	
Total Investments	£39,900,000	0.57%				0.001%

Counterparty Fitch Rating	£	%
AAmmf	22,200,000	56%
A+	5,000,000	13%
AA-	5,300,000	13%
A	2,000,000	5%
A-	3,400,000	8%
Unrated Building Societies	2,000,000	5%
TOTAL	**39,900,000**	**100%**



Investments by Counterparty	Type	£	%
Federated Investors	MMF	4,500,000	11%
Goldman MMF	MMF	3,700,000	9%
Aberdeen Asset Management	MMF	1,200,000	3%
Standard Life Investments	MMF	3,800,000	10%
Federated Cash Fund	Short Duration	5,000,000	13%
Royal London Asset Management	Short Duration	2,000,000	5%
Payden Global Funds	Short Duration	2,000,000	5%
Svenska	Non-UK Bank	5,300,000	13%
Barclays	UK Bank	2,400,000	6%
Standard Chartered	UK Bank	5,000,000	13%
Cumberland Building Society	UK Build Soc	1,000,000	3%
Leeds Building Society	UK Build Soc	1,000,000	3%
Vernon Building Society	UK Build Soc	1,000,000	3%
Goldman Sachs International Bank	UK Bank	2,000,000	5%
TOTAL		**39,900,000**	**100%**



Detailed Economic Commentary on Developments During Quarter Ended 30th June 2015

- During the quarter ended 30th June 2015:
    - The economic recovery slowed in the first quarter of 2015/16;
    - Survey measures pointed to renewed vigour in Q2;
    - Wage growth picked up as the labour market tightens;
    - Deflation lasted only one month, but the outlook remain subdued;
    - Another split vote on the MPC drew nearer, but a rate hike this year remained unlikely;
    - The general election confirmed that the fiscal squeeze will re-intensify next year;
    - The possibility of a Greek exit from the Eurozone became greater.
- The latest economic data showed that the recovery slowed in the first quarter. However, the latest National Accounts painted the recovery in a better light than previously thought. Indeed, Q1's quarterly GDP growth estimate was nudged up from 0.3% to 0.4% on the back of some stronger construction data.
- Business surveys suggest that the recovery got swiftly back on track at the beginning of Q2 and early indicators suggest that the recovery in household spending has maintained plenty of momentum. What's more, spending off the high street looks to have remained robust as well. The Bank of England's Agents' Score of turnover in the services sector points to a further acceleration in nominal spending on services in the near term. In addition, the latest consumer confidence figures suggest that households still think now is a good time to undertake major purchases.
- Household spending should continue to be supported by developments in the labour market. The ILO unemployment rate has now fallen to 5.5%, not far above pre-crisis levels. And the employment rate is the highest since records began. The significant tightening in the labour market over the past eighteen months or so has begun to feed through into pay, with annual growth in headline average weekly earnings (excluding bonuses) picking up to 2.7% in April, its strongest since February 2009. Nominal wage growth is expected to strengthen further over the coming months as the unemployment rate continues to nudge down. The subdued outlook for inflation should underpin real wage growth.
- The latest consumer prices figures showed that deflation lasted just one month. CPI inflation rose from -0.1% in April to +0.1% in May, reflecting the slower pace of falls in food prices and a rebound in petrol prices. Data suggested that deflation was likely to be fleeting, as it primarily reflected temporary external factors such as the fall in energy prices and food prices, as well as an appreciation in sterling, rather than weakness in domestic demand. Meanwhile, there have not been any signs that very low inflation has had any adverse second round effects on inflation expectations or spending decisions. Nonetheless, inflation looks set to hover just above zero for the next six months, and it wouldn't take much during that period, perhaps a renewed 10% fall in the oil price, for the UK to be tipped back into deflation.
- Unsurprisingly, then, the Monetary Policy Committee do not appear to be in any rush to raise interest rates. Granted, the minutes of June's MPC meeting showed that for two members, the decision to leave rates on hold was "finely balanced". And a recent interview with the Financial Times, resident MPC hawk Martin Weale suggested that he is not too far off restoring his vote to raise rates again. But with inflation close to zero and the situation in Greece becoming increasingly

troubling, it looks that they will wait at least another few months before turning against the grain again. And with the rest of the committee likely to stand pat for even longer, it looks unlikely that there will be an increase in interest rates this year.

- Meanwhile, with the Conservatives winning an outright majority in May's general election, the fiscal squeeze is set to re-intensify next year. In order to meet their manifesto pledge, the Conservatives will have to implement a fiscal consolidation worth around 5% of GDP over the next four years. And given that they have pledged to not increase VAT, income tax or national insurance in the next parliament, more of the planned squeeze will have to come through cuts to spending than in the last parliament. Admittedly, these plans may be watered down, but it is clear that fiscal policy will be a hindrance, not a help, to the economic recovery over the next few years, and underlines that monetary policy will have to remain extremely accommodative. Meanwhile, the general election brought with it another cloud to the economic recovery – namely a referendum on the UK's membership of the European Union which could happen during 2016, though a May date now appears unlikely.
- Internationally, the major development over the past quarter has been the deterioration of the situation in Greece. Whilst the UK's direct economic and financial exposures to Greece are small, there could be an adverse impact on the UK's economy from a wider fallout and period of general financial market instability that would be likely to prevail if a Greek exit were to occur.

Detailed Commentary on Interest Rate Forecasts and Capita Asset Services' Forward View

Our treasury management advisers, Capita Asset Services have provided us with the following update to their interest rate forecasts and outlook.

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%
5yr PWLB rate	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%
25yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%
50yr PWLB rate	3.60%	3.70%	3.80%	4.00%	4.10%	4.20%	4.30%	4.40%	4.40%	4.50%	4.60%

- Economic forecasting remains difficult with so many external influences weighing on the UK. The above Bank Rate forecasts will be liable to further amendment depending on how economic data transpires over 2015. 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.

- In its May Inflation Report, the Bank of England reduced its forecasts for annual growth from 2.9% to 2.5% in 2015 and 2.7% in 2016. 2017 growth was forecast at 2.4% from 2.7%. There were a number of contributing factors to these downward revisions.

- The Bank also took a more pessimistic view on the rate of, and timing of, the keenly hoped for recovery of growth in labour productivity and of increases in wages; it cut its forecast for wages growth in 2015 from 3.5% to 2.5%. This is despite strong growth in employment and continuing reductions in the rate of unemployment; employment increased by 202,000 in the three months January to March and by 1.25m over the last two years. Unemployment has dropped by 386,000 over the last year and the unemployment rate has fallen to 5.5%. On the other hand, job vacancies stood at 736,000 in the last quarter, close to their highest level since records began in 2001. Despite all this positive news, annual wage increases (excluding bonuses) in the last three months were only 1.9%. For this recovery to become sustainable over the longer term, there must be a recovery in the growth of productivity and real wages in excess of the rate of inflation.

- CPI inflation dipped into deflation territory, falling to -0.1%. This dip into deflation will only last for a short period until the fall in the prices of oil and food drop out of the twelve month calculation of CPI, especially during Q4 2015, when inflation is expected to tick up markedly. The latest Inflation Report clearly shows an anticipated rise in inflation to being slightly above the 2% target in the two to three year time horizon.

- The PWLB certainty rates for the quarter ended 30th June 2015 are shown below:

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.11%	1.82%	2.40%	3.06%	3.01%
Date	02/04/2015	02/04/2015	02/04/2015	02/04/2015	02/04/2015
High	1.33%	2.32%	3.04%	3.65%	3.55%
Date	25/06/2015	25/06/2015	10/06/2015	24/06/2015	04/06/2015
Average	1.23%	2.09%	2.75%	3.37%	3.29%

- A high level of volatility in PWLB rates over 2015 should be expected, as there are many factors impinging on market and investor sentiment. PWLB rates could swing by 50 bps in a quarter, which makes any forecasts in the shorter term subject to a much higher level of volatility than has been usual.

- The overall longer run trend is 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.

- The American economy experienced disappointing growth in quarter 1 2015, contracting by 0.2% on an annualised basis, due to bad weather hitting construction and consumer spending, a ports strike and the near 20% appreciation in the value of the dollar. However, it is expected to recover strongly in quarter 2 and resume its trend of making a full recovery from the financial crash. GDP growth for 2014 as a whole of 2.4% holds great promise for strong growth going forward and for further falls in unemployment. It is therefore expected that the Fed will start on the first increase in the Fed rate during 2015 and is likely to be ahead of the UK in being the first major western country to raise rates.

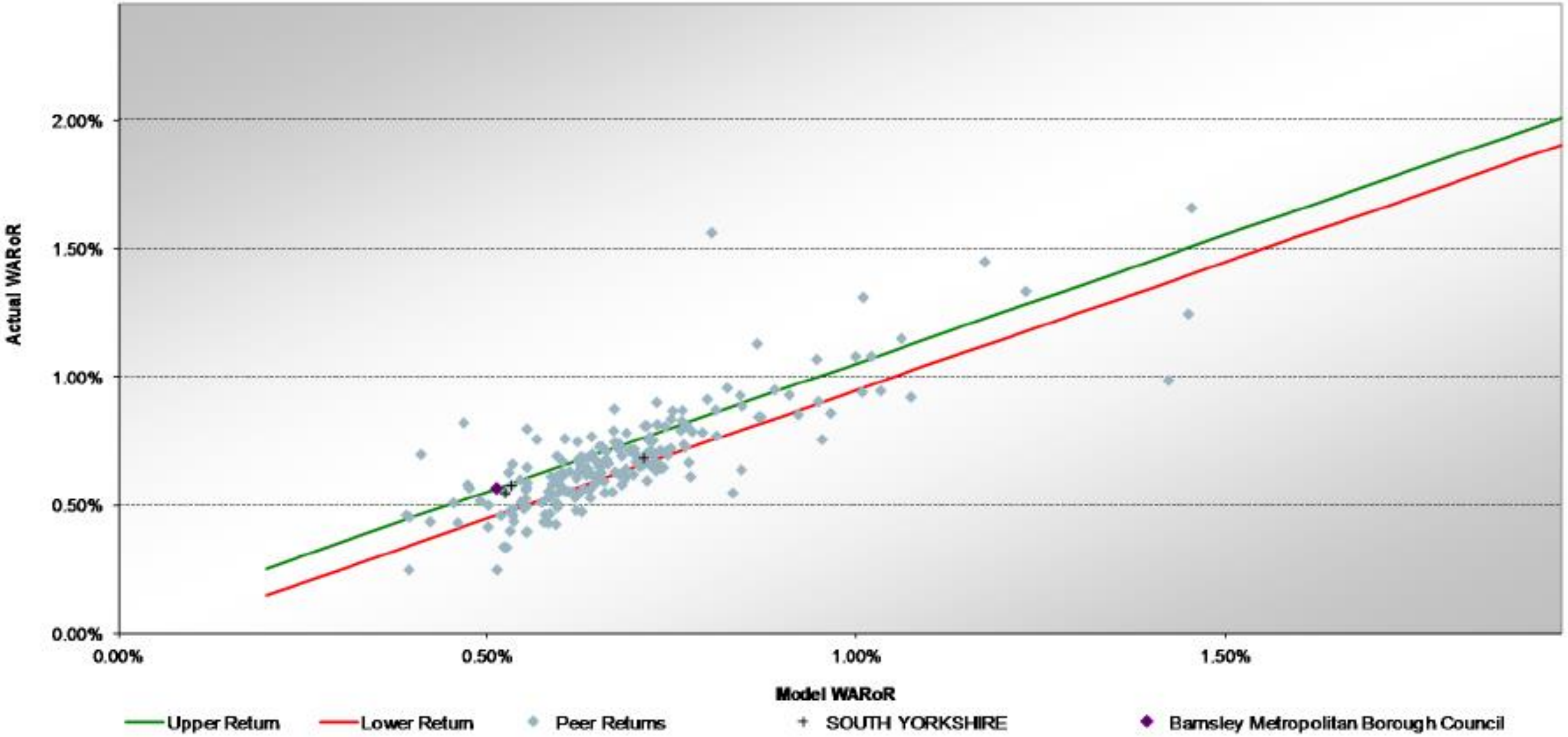
- As for the Eurozone, the ECB announced a massive €1.1 trillion programme of Quantitative Easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme started in March and will run to September 2016. This seems to have already had a beneficial impact in improving confidence and sentiment. 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% y/y). Deflation has also ended with a return into positive territory with an increase from 0.0% in April to +0.3% in May. In May, ten year bond yields shot up by around 50 bps after having dipped to near zero for a brief period.

- 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.

CAPITA

Asset Services

Investment Benchmarking June 2015 – Barnsley MBC



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Barnsley Metropolitan Borough Council	0.57%	0.51%	0.06%	0.46%	0.56%	Above