Committee:	Date:
Financial Investment Board	1 December 2016
Subject: Mid Year Treasury Management Review 2016-17	**Public**
Report of: The Chamberlain	**For Information**
Report author: Kate Limna – Corporate Treasurer	

Summary

The Treasury Management Strategy Statement for 2016/17 was approved by the Financial Investment Board and the Finance Committee in February 2016 and by the Court of Common Council on 3 March 2016.

Under CIPFA's Code of Practice on Treasury Management, which was adopted by the Court of Common Council on 3 March 2010, there is a requirement to provide a mid-year review. The main points to note are as follows:

- Following approval of the 2016/17 Treasury Management Strategy Statement, the Treasury Management Indicators were amended to accommodate a property transaction.
- As at 30 September 2016, the City had cash balances totalling some £948.33m. The majority of the balances are held for payment to third parties or are restricted reserves. Some £200m is being held as part of the City's contribution to Crossrail**.** This contribution was originally due to be paid in March 2016 but this has been pushed back to March 2017.
- As the cash holdings in money market funds are considerable, the City is looking at alternative investments for its cash balances in consultation with its Treasury Management Advisors, Capita Asset Services.

Recommendation

Members are asked to note the report.

Main Report

Introduction

1. The City of London Corporation (the City) is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the City's low risk appetite, providing adequate liquidity initially before considering investment return.

2. The second main function of the treasury management service is the funding of capital expenditure plans. The City is not anticipating any borrowing at this time.

3. The City's Treasury Management activities are undertaken in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) which was adopted by the Court of Common Council on 3 March 2010.

4. The City defines its treasury management activities as:

   The management of the organisation'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.

Treasury Management Strategy Statement and Annual Investment Strategy Update

5. The Treasury Management Strategy Statement for 2016/17 was approved by the Financial Investment Board (4 February 2016) and the Finance Committee (16 February 2016) and the Court of Common Council (3 March 2016).

6. In March 2016 it was necessary to amend the Treasury Management Indicators to accommodate a specific property transaction. This change was agreed under the City's Urgency Procedures and Appendix 1 sets out the changes

Investment Portfolio

7. It is the City's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with its risk appetite. The underlying economic environment remains challenging for the City and 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 current 0.25% Bank Base Rate.

8. The City held £948.3m of investments as at 30 September 2016 (£858.8m at 31 March 2016). The majority of the balances are held for payment to third parties or are restricted reserves. Some £200m is being held as part of the City's contribution to Crossrail – this contribution was originally due to be paid in March 2016 but this has been pushed back to March 2017. It is becoming increasingly difficult to find suitable counterparties to invest in and your officers are consulting with Capita Asset Services (the City's Treasury Management Advisors) on alternative investments. An initial meeting has taken place and officers are undertaking a cash flow modelling exercise that will take account of the City's short, medium and long term spending plans.

Borrowing Strategy

9. It is anticipated that there will be no capital borrowings required during 2016/17.

Economic Review

10. A detailed commentary on the economy and interest rates as provided by Capita Asset Services (the City's Treasury Management advisors) can be found at Appendix 2. In summary they currently expect the bank base rate to be reduced to 0.1% in December and to remain at this level until June 2018.

Conclusion

11. The City continues to hold considerable cash balances in money market funds and it is becoming increasingly difficult to find suitable counterparties and reasonable returns. The Bank of England base rate was cut from 0.5% to 0.25% on 4 August and it is likely that there will be a further cut to 0.1%. In consultation with Capita Asset Services, officers are looking at alternative investments and undertaking a cash flow modelling exercise which will take account of the City's spending plans over the short, medium and long term.

Appendices

Appendix 1 – Changes to the 2016/17 Treasury Management Strategy (March 2016)
Appendix 2 - Economic and Interest Rate Update from Capita Asset Services

Kate Limna
Corporate Treasurer

T: 020 7332 3952
E: kate.limna@cityoflondon.gov.uk

Appendix 1

Changes to the 2016/17 Treasury Management Strategy Statement – March 2016

Extract from 2016/17 Treasury Management Strategy Statement and Annual Investment Strategy (TMSS & AIS): Section 2 and Appendix 3: Table 1

Section 2 Treasury Limits for 2016/17 to 2018/19

It is a statutory duty under Section 3 (1) of the Local Government Finance Act and supporting regulations, for the City to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The City must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability including credit arrangements e.g. finance leases. The Authorised Limit is to be set on a rolling basis for the forthcoming financial year and two successive financial years.

Appendix 3: Table 1 (Extract)

CURRENT TREASURY MANAGEMENT INDICATORS	2014/15	2015/16	2016/17	2017/18	2018/19
	actual	probable outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
TOTAL	£0	£0	£0	£0	£0
Operational Boundary for external debt -					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
TOTAL	£0	£0	£0	£0	£0

The table above is an extract from Appendix 3 Table 1 of the TMSS& AIS showing the current Authorised Limit, whilst the table below shows the changes required.

PROPOSED TREASURY MANAGEMENT INDICATORS	2014/15	2015/16	2016/17	2017/18	2018/19
	actual	probable outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt - *					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£27,510	£27,460	£27,410	£27,360
TOTAL	£0	£27,510	£27,460	£27,410	£27,360
Operational Boundary for external debt - *					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£27,510	£27,460	£27,410	£27,360
TOTAL	£0	£27,510	£27,460	£27,410	£27,360

* The purpose of this indicator is simply to highlight the liability element of this agreement – it does not take account of the overall net benefit to the Corporation.

* The controls effectively treat the City's one-off premium for the lease as a payment in advance for an ongoing rental liability over the lease term – with this 'liability' classed as borrowing. However, the City continues to have no external borrowing.

Appendix 2

Economic and Interest Rate Update from Capita Asset Services

Economic Update

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year 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. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result, that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3% (+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

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

Interest Rate forecasts

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

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later. Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when the growth in average disposable income is still weak and could well turn negative when inflation rises during the next two years to exceed average pay increases.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates. Our PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The overall balance of risks to economic recovery in the UK remains to the downside. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Weak capitalisation of some European banks.
- A resurgence of the Eurozone sovereign debt crisis.
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a further flight to safe havens (bonds).
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

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