QUARTERLY TREASURY MANAGEMENT REPORT – QTR. 1

1. Borrowing Requirement and Debt Management

The Authority's chief objective when borrowing continues to be striking an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective

As at the 30 June 2016, the council's overall outstanding long term borrowing was £238M, at an average rate of 3.33% and an average maturity of 23 years, this has fallen by £3M since the last reported figure at 31 March due to maturing debt which has not yet been replaced. The total long term debt portfolio is made up of loans from the Public Works Loan Board (PWLB) of £229M and market loans of £9M.

Included within the PWLB portfolio is £35M of variable rate loans, which are currently averaging 0.69% and are helping to keep overall borrowing costs down. Whilst in the current climate of low interest rates this remains a sound strategy, the Council need to review these regularly and if appropriate switching into fixed rate loans if interest rates start to rise rapidly.

The Council does not have any temporary borrowing at present having repaid outstanding balances in April, and whilst these have remained affordable and attractive, due to our continued high level of cash (and subsequent investments) no need has arisen.

As at the 31 March 2016 the Council used £106M of internal resources in lieu of borrowing which has been the most cost effective means of funding past capital expenditure to date. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium to long term and the Council will need to borrow to cover this amount as balances fall.

Based on the latest Capital update the Council is expected to have a borrowing need up to £159.3M between 2016/17 and 2018/19. Of this £48.3M relates to new HRA capital spend, £92.9M for new capital spend on the GF, including £65M that has been allocated for the purchase of property for income generation, the remainder relates to the refinancing of existing debt and externalising internal debt to cover expected fall in balances.

No new borrowing has been taken to date and none is expected to be taken until later in the year and will be assessed in conjunction with the development of the capital programme, cash balances and advice from the Council's treasury advisor.

Any borrowing taken this year is likely to be short term in nature to take advantage of the existing low interest rate and to protect ourselves against a predicted fall in interest rates following the UK's vote to leave the European Union and the subsequent uncertainty. It will take some time before the full implications of 'Brexit' are known.

Budgeted Expenditure

The interest cost of financing the Authority's long term and short term loan debt is charged corporately to the Income and Expenditure account. The interest cost in 2016/17 of financing the Authority's loan debt is currently expected to be £11.8M of which £5.9M relates to the HRA

2. Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its TM Strategy Statement for 2016/17.

Counterparty credit quality is assessed and monitored with reference to: Credit Ratings; credit default swaps; financial statements, information on potential government support and reports in the quality financial press.

Internal investments

Balances initially increased at the beginning of the year rising from £89M to £106M in mid-April, but have since fallen back to £84M, £16M less than the same time last year. Current cash flow forecast indicate that this will fall further to around £60M by the end of September, of which £42M is in fixed term deals. If this forecast materialises in order to maintain our working cash flow balance of between £20M and £25M we may need an input of temporary borrowing towards the end of September.

As reported previously, following advice from our advisors Arlingclose, we have invested in bonds to optimise investment income, including corporate bonds as an alternative to fixed term deposits with banks as although the risk of insolvency remains, there is no risk of pre-emptive bail-in by the regulator and corporates are far less geared than banks. These deals will generate around £0.45M for the year.

The Authority has internal investments amounting to £78.8M, with an average rate of return of 1.43% as detailed in Table 1 below:

Table 1: Quarter 1 Internal Investments

Investments	At 30 June 2016 £000	Date of Maturity	Yield %	Rating
Cash				
Barclays Bank PLC	3,000	Call	0.40	A
Santander UK Plc	5,000	180 Day Notice	1.16	A
Aberdeen MMF	9,000	MMF	0.53	A+
Blackrock MMF	70	MMF	0.49	AA-
Deutche MMF	8	MMF	0.43	AA-
Federated Prime MMF	8,620	MMF	0.54	AA-
Goldman Sachs MMF	26	MMF	0.44	AA
Insight MMF	20	MMF	0.46	A+

Invesco MMF	4,000	MMF	0.52	AA-
J P Morgan MMF	287	MMF	0.49	AA-
Standard Life MMF	7,660	MMF	0.53	A+
Total Cash	**37,691**		**0.60**	
Corporate Bonds				
Mobility Operations Group Plc	3,801	28/09/2016	1.06	A+
Places for People Capital Markets	2,486	27/12/2016	1.34	A
National Grid Gas plc	3,154	07/06/2017	0.87	A-
Total Corporate Bonds	**9,441**		**1.09**	
Other Short Term Bonds				
Nederlandse Waterschapsbank	4,843	07/09/2016	0.72	AA+
Bank of Scotland PLC Covered Bond	4,176	08/11/2016	0.74	AAA
Laneskreditbank Baden-Wuert	2,043	15/12/2016	0.72	AAA
Lloyds Bank Covered Bond	2,006	16/01/2017	0.68	AAA
Abbey National Treasury plc Covered Bond	3,008	20/01/2017	0.81	AAA
Total Other Bonds	**16,076**		**0.75**	
Long Term Bonds				
Nationwide Building Society Covered Bond	1,485	17/07/2017	0.68	AAA
Leeds Building Society Covered Bond	2,004	09/02/2018	0.82	AAA
Barclays Bank Covered Bond	1,002	12/02/2018	0.71	AAA
Yorkshire Building Society Covered Bond	3,297	12/08/2018	1.94	AA+
Nationwide Building Society Covered Bond	1,601	25/04/2019	1.05	AAA

Leeds Building Society Covered Bond	3,010	01/10/2019	0.82	AAA
European Investment Bank - Bond	1,069	15/04/2025	5.27	AAA
European Investment Bank - Bond	1,054	07/06/2025	5.16	AAA
European Investment Bank - Bond	1,039	07/06/2025	5.49	AAA
Total Long Term Bonds	**15,561**		**2.08**	
Total Bonds	**41,078**		**1.44**	
Total Investments	**78,769**		**1.43**	

External Managed investments

The Council currently has £7M in property funds which offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term. These funds are managed by professional fund managers which allows the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. As at the 30 June the sell price of our total investments were valued at £7.2M a notional "gain" of £0.2M against investments, this is lower than that previously reported as following 'Brexit' CCLA have prudently adjusting the fund value downwards by approximately 4% for the end of June price, based on their valuer's advice. This is in line with the 4 or 5% adjustments being made by other property funds at this time. Our advisers Arlingclose have issued the following statement, 'We believe this is a prudent step taken by CCLA to protect continuing investors in the fund from anyone attempting to sell at "off-market" pre-referendum prices. After all, Brexit is a significant event with wide but largely unknown implications. We advise clients to invest in this fund with a rolling five year investment horizon, with the aim of collecting steady income and to see through price volatility. Our advice therefore continues to be that clients should not sell strategic investments at this time, and we are confident that income distribution will remain significantly higher than cash over the coming years'.

The current quoted dividend yield on the fund is currently 4.99% and is expected to return £0.33M for the year (based on the average return of the last 12 months 4.76%)

Budgeted Income

The Council does not expect any losses from non-performance in relation to its investments by any of its counterparties. The UK Bank Rate has been maintained at 0.5% since March 2009 and as a consequence short-term money market rates have remained at relatively low levels and are expected to fall further following 'Brexit'. Investments in Money Market Funds and call accounts currently generated an average rate of 0.60%. Investments in bonds have performed better returning an average of 1.47% for the year to date. The average cash balances during the quarter was £91.8M; these are expected to decline during the financial year as the incidence of government grant income and council tax income is skewed towards the earlier part of the year.

The Authority's budgeted investment income for the year is forecast at £0.4M. As reported previously the Authority continues to review investments in suitable longer term financial instruments which will generate a better return, as it is envisaged that there be sufficient cash balances over the medium term.

3. **Compliance with Prudential Indicators**

The Council can confirm that it has complied with its Prudential Indicators for 2016/17 approved by Full Council on 10 February 2016. Table 2 below summarises the Key Prudential Indictors and performance to date:

Table 2: Compliance with Prudential Indicators

Indicator	Limit	Actual at 30 June 2016
Authorised Limit for external debt £M	£863M	£318M
Operational Limit for external debt £M	£700M	£318M
Maximum external borrowing year to date		£238M
Limit of fixed interest debt %	100%	82%
Limit of variable interest debt %	50%	18%
Limit for Non-specified investments £M	£70M	£32M

5. Financial Advisor's (Arlingclose) Outlook for the remainder of 2016/17

Following the UK's vote to leave the European Union, the economic outlook for the UK has immeasurably altered. It will to a large extent be dependent on the nature of the future relationship negotiated with the EU, particularly in relationship to trade. The negotiations crucially hinge on domestic politics which, at the end of the June quarter, were unsettled themselves.

The domestic outlook is uncertain, but likely to be substantially weaker in the short term than previously forecast. Arlingclose has changed its central case for the path of Bank Rate over the next three years. Arlingclose believes any currency-driven inflationary pressure will be looked through by Bank of England policymakers. The likely path for Bank Rate is downwards and the central case is 0.25%, but there is a 40% possibility of that the rate is cut to zero.

	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19
Official Bank Rate													
Upside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

In addition, Arlingclose believes that the Government and the Bank of England have both the tools and the willingness to use them to prevent any immediate market-wide problems leading to bank insolvencies. The cautious approach to credit advice means that the banks currently on the Authority's counterparty list have sufficient equity buffers to deal with any localised problems in the short term.