Semi-Annual Treasury Report 2010/11

1. Introduction

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end).

The Council's Treasury Management Strategy for 2015/16 was approved by full Council on 17th February 2015 which can be accessed on :-

http://rds.eppingforestdc.gov.uk/ieListDocuments.aspx?CId=296&MId=7954&Ver=4 .

The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

2. External Context

As the year began, economic data was largely overshadowed by events in Greece. Markets' attention centred on the never-ending Greek issue stumbled from turmoil to crisis, running the serious risk of a disorderly exit from the Euro. The country's politicians and the representatives of the 'Troika' of its creditors - the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) – barely saw eye to eye. Greece failed to make a scheduled repayment to the IMF on 30th June, in itself not a default until the IMF's Managing Director declares it so. Prime Minister Tsipras blindsided Greece's creditors by calling a referendum on 5th July on reform proposals which by then were off the table anyway. The European Central Bank froze liquidity assistance provided to Greek banks and capital controls within the country severely restricted individuals' and corporates' access to cash.

On 12th July, following a weekend European Union Summit, it was announced that the terms for a third bailout of Greece had been reached. The deal amounting to €86 billion was agreed under the terms that Greece would see tax increases, pension reforms and privatisations; the very reforms Tsipras had vowed to resist. This U-turn saw a revolt within the ruling Syriza party and on 27th August, Alexis Tsipras resigned from his post as Prime Minster of Greece after just eight months in office by calling a snap election, held on 20th September. This gamble paid off as Tsipras led his party to victory once again, although a coalition with the Independent Greeks was needed for a slim parliamentary majority. That government must now continue with the unenviable task of guiding Greece through the continuing economic crisis – the Greek saga is far from over.

The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months with a reported $3.2 trillion loss to investors, on the back of concerns over growth and after regulators clamped down on margin lending activity in an effort to stop investors borrowing to invest and feeding the stock market bubble. Chinese authorities intensified their intervention in the markets by halting trading in many stocks in an attempt to maintain market confidence. They surprised global markets in August as the People's Bank of China changed the way the yuan is fixed each day against the US dollar and allowed an aggressive devaluation of the currency. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. On 24th August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and

are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

UK Economy: The economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.7%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%. GDP has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to -0.1%, before fluctuating between 0.0% and 0.1% over the next few months. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the ILO unemployment rate for the three months to July fall to 5.5%. In the September report, average earnings excluding bonuses for the three months to July rose 2.9% year/year.

The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

The US economy slowed to 0.6% in Q1 2015 due to bad weather, spending cuts by energy firms and the effects of a strong dollar. However, Q2 GDP showed a large improvement at a twice-revised 3.9% (annualised). This was largely due to a broad recovery in corporate investment alongside a stronger performance from consumer and government spending and construction and exports. With the Fed's decision on US interest rate dependent upon data, GDP is clearly supportive. However it is not as simple as that and the Fed are keen to see inflation rise alongside its headline economic growth and also its labour markets. The Committee decided not to act at its September meeting as many had been anticipating but have signalled rates rising before the end of the year.

Market reaction: Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight on 'Black Monday'. Indices have not recovered to their previous levels but some improvement has been seen. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Concerns around China saw bond yields dropping again through August and September. Bond markets were also distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory.

Local Context

At 31/3/2015 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £184.7m, while usable reserves and working capital which are the underlying resources available for investment were £114.9m.

Semi-annual Treasury Report 2015/16

At 31/3/2015, the Council had £185.5m of borrowing and £67.4m of investments. The Council's current strategy is to use internal borrowing (running down the Council's cash balances), subject to holding a minimum investment balance of £10m.

The Council has an increasing CFR over the next 3 years due to the capital programme and approved capital projects, but investments will fall and the Council will therefore be required to borrow up to £30m over the forecast period.

Borrowing Strategy

At 30/9/2015 the Council held £185.5m of loans, (no change on the position as at 31/3/2015), as part of its strategy for funding the Self-Financing Housing deal.

The Council does not expect to borrow in 2015/16, but does expect to borrow up to £30m by the end of 2016/17.

The Council'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 Council's long-term plans change being a secondary objective.

Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the Council determined it was more cost effective in the short-term to use internal resources.

The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Council with this 'cost of carry' and breakeven analysis.

£31.8m of PWLB variable rate loans were borrowed in 2012 at an average rate of 0.62% which mitigates the impact of changes in variable rates on the Authority's overall treasury portfolio (most of the Council's investments are deemed to be variable rate investments due to their short-term nature). This strategic exposure to variable interest rates will be regularly reviewed and, if appropriate, reduced by switching into fixed rate loans.

Semi-annual Treasury Report 2015/16

Borrowing Activity in 2015/16

	Balance on 01/04/2015 £m	Maturing Debt £m	Debt Prematurely Repaid £m	New Borrowing £m	Balance on 30/09/2015 £m	Avg Rate % and Avg Life (yrs)
CFR	184.7				184.7	
Short Term Borrowing[1]	0	0	0	0	0	
Long Term Borrowing	185.5	0	0	0	185.5	3% - 22 years
TOTAL BORROWING	185.5	0	0	0	185.5	
Other Long Term Liabilities	0	0	0	0	0	
TOTAL EXTERNAL DEBT	185.5	0	0	0	185.5	
Increase/ (Decrease) in Borrowing £m					0	

PWLB Certainty Rate and Project Rate Update: The Council qualifies for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12 month period from 01/11/2014. In April the Council submitted its 2015/16 Capital Estimates Return to access this reduced rate for a further 12 month period from 01/11/2015. Published shortly on the DMO website.

Debt Rescheduling:
The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Cashflow forecasts indicated that during 2015/16 the Authority's investment balances would range between £67m and £35 million.

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Authority's aim is to achieve a yield commensurate with these principles.

[1] Loans with maturities less than 1 year.

Semi-annual Treasury Report 2015/16

Investment Activity in 2015/16

Investments	Balance on 01/04/2015 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 30/09/2015 £m	Avg Rate/Yield (%) and Avg Life years)
Short term Investments (call accounts, deposits) - Banks and Building Societies with ratings of A- or higher - Local Authorities	47.4	63	72.3	38.1	0.61% - 147 days
Long term Investments - Banks and Building Societies with ratings of A+ or higher - Local Authorities	5	0	0	5	1.3% - 413 days
Money Market Funds	15	5	10	10	0.49%
TOTAL INVESTMENTS	67.4	68	82.3	53.1	
Increase/ (Decrease) in Investments £m				(14.3)	

Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16.

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is A- across rating agencies Fitch, S&P and Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Credit Risk
Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average - Credit Risk Score	Value Weighted Average - Credit Rating	Time Weighted Average - Credit Risk Score	Time Weighted Average - Credit Rating
31/03/2015	A+	5.10	AA-	3.98
30/06/2015	A+	5.17	AA-	3.68
30/09/2015	A+	5.34	AA-	4.44

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Semi-annual Treasury Report 2015/16

Investment Activity

£5 million has been placed Long Term with a UK Local Authority. £10 million was placed with Money Market Funds as being readily available. Slightly better yields are obtained with the £38 million placed mainly with UK Banks and Building Societies.

Counterparty Update

All three credit ratings agencies have reviewed their ratings in the six months to reflect the loss of government support for most financial institutions and the potential for varying loss given defaults as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

Fitch reviewed the credit ratings of multiple institutions in May. Most UK banks had their support rating revised from 1 (denoting an extremely high probability of support) to 5 (denoting external support cannot be relied upon). This resulted in the downgrade of the long-term ratings of Royal Bank of Scotland (RBS) to BBB+ from A, Deutsche Bank to A from A+, Bank Nederlandse Gemeeten to AA+ from AAA and ING to A from A+. JP Morgan Chase and the Lloyds Banking Group however both received one notch upgrades.

Moody's concluded its review in June and upgraded the long-term ratings of Close Brothers, Standard Chartered Bank, ING Bank, Goldman Sachs International, HSBC, RBS, Coventry Building Society, Leeds Building Society, Nationwide Building Society, Svenska Handelsbanken and Landesbank Hessen-Thueringen.

S&P reviewed UK and German banks in June downgrading Barclays' long-term rating to A- from A, RBS to BBB+ from A- and Deutsche Bank to BBB+ from A. S&P has also revised the outlook of the UK as a whole to negative from stable, citing concerns around a planned referendum on EU membership and its effect on the economy.

National Australia Bank (NAB) announced its plans to divest Clydesdale Bank, its UK subsidiary. NAB is looking to list Clydesdale on the London Stock Exchange and transfer ownership to NAB's current shareholders. Fitch placed the long- and short-term ratings of the bank on rating watch negative which the agency is expected to resolve once the transaction has been completed. S&P has also placed the long-term rating of Clydesdale Bank on CreditWatch negative following the announcement.

At the end of July, the Council's treasury advisors Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank being added as a new recommended counterparty and certain non-rated UK building societies also being extended.

Semi-annual Treasury Report 2015/16

Budgeted Income and Outturn

The average investment balances were £55.6m during the quarter. The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates have remained at relatively low levels (see Table 1 in Appendix 2). New deposits were made at an average rate of 0.61%. Investments in Money Market Funds generated an average rate of 0.49%.

The Council's budgeted investment income for the year is estimated at £0.47m. The Council anticipates an investment outturn of £0.425m for the whole year.

Update on Investments with Icelandic Banks

Total received £2.46m (98.00%). The 15th dividend of £99,979.39 was received at the end of August 2015. There has been no further update from Ernst and Young.

Compliance with Prudential Indicators

The Authority confirms compliance with its Prudential Indicators for 2015/16, which were approved on the 17th February by Full Council as part of the Council's Treasury Management Strategy Statement.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the percentage of net principal borrowed or interest payable will be:

D = Debt I = Investment	**2015/16**	**2016/17**	**2017/18**
Upper limit on fixed interest rate exposure	100 D/100 I	100 D/100 I	100 D/100 I
Actual	83 D/ 91 I		
Upper limit on variable interest rate exposure	25 D/75 I	25 D/75 I	25 D/75 I
Actual	17 D/ 9 I		

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**	**Actual**
Under 12 months	100%	0%	0%
12 months and within 24 months	100%	0%	0%
24 months and within 5 years	100%	0%	0%

5 years and within 10 years	100%	0%	17%
10 years and within 20 years	100%	0%	0%
20 years and within 30 years	100%	0%	83%
30 years and within 40 years	100%	0%	0%
40 years and within 50 years	100%	0%	0%
50 years and above	100%	0%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2015/16	2016/17	2017/18
Limit on principal invested beyond year end	£30m	£30m	£30m
Actual	£5m		

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit score	A-	A+

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target	Actual
Total cash available within 3 months	£20m	£29m

Other Prudential Indicators

The following three prudential indicators are relevant to the treasury function as they concern limits on borrowing and the adoption of the CIPFA Treasury Management Code.

Semi-annual Treasury Report 2015/16

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m
Borrowing	204.0	**219.0**	219.0	219.0
Total Debt	**204.0**	**219.0**	**219.0**	**219.0**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m
Borrowing	230.0	**230.0**	230.0	230.0
Total Debt	**230.0**	**230.0**	**230.0**	**230.0**

Adoption of the CIPFA Treasury Management Code: The Council approved the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* at its meeting on the 22nd April 2002.

Outlook for Q3 and Q4 2015/16

Arlingclose's expectation for the first rise in the Bank Rate (base rate) remains the second calendar quarter of 2016. The pace of interest rate rises will be gradual and the extent of rises limited. The appropriate level for Bank Rate for the post-crisis UK economy is likely to be lower than the previous norm. We would suggest this is between 2.0% and 3.0%. There is also sufficient momentum in the US economy for the Federal Reserve to raise interest rates in 2015, although risks of issues from China could possibly push this back.

The weak global environment and resulting low inflation expectations are likely to dampen long term interest rates. We project gilt yields will follow a shallow upward path in the medium term, with continuing concerns about the Eurozone, and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued. The uncertainties surrounding the timing of UK and US interest rate rises, and the Chinese stock market-led turmoil, are likely to prompt short term volatility in gilt yields.

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Average
Official Bank Rate														
Upside risk			0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.32
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.08
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-0.70

Semi-annual Treasury Report 2015/16

Appendix 2

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below.

Please note that the PWLB rates below are Standard Rates. Authorities eligible for the Certainty Rate can borrow at a 0.20% reduction.

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2015		0.50		0.35	0.46	0.43	0.51	0.76	0.97	0.87	1.05	1.32
30/04/2015		0.50		0.35	0.48	0.43	0.52	0.74	0.98	1.00	1.21	1.51
31/05/2015		0.50		0.43	0.50	0.43	0.52	0.75	0.98	0.97	1.18	1.49
30/06/2015		0.50		0.35	0.45	0.43	0.52	0.79	0.99	1.09	1.35	1.68
31/07/2015		0.50		0.32	0.43	0.43	0.53	0.79	1.01	1.10	1.33	1.66
31/08/2015		0.50		0.42	0.40	0.43	0.54	0.82	1.02	1.03	1.24	1.61
30/09/2015		0.50		0.37	0.41	0.43	0.54	0.74	1.00	0.93	1.11	1.41
Average		**0.50**		**0.40**	**0.46**	**0.43**	**0.53**	**0.76**	**0.99**	**1.03**	**1.25**	**1.58**
Maximum		**0.50**		**0.48**	**0.58**	**0.56**	**0.65**	**0.86**	**1.02**	**1.17**	**1.44**	**1.82**
Minimum		**0.50**		**0.17**	**0.40**	**0.43**	**0.51**	**0.55**	**0.97**	**0.87**	**1.04**	**1.29**
Spread		**--**		**0.31**	**0.18**	**0.13**	**0.14**	**0.31**	**0.05**	**0.30**	**0.40**	**0.53**

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2015	128/15	1.32	2.07	2.66	3.21	3.34	3.30	3.28
30/04/2015	166/15	1.41	2.27	2.90	3.44	3.55	3.50	3.48
29/05/2015	204/15	1.44	2.26	2.90	3.44	3.54	3.48	3.45
30/06/2015	248/15	1.48	2.44	3.13	3.65	3.72	3.64	3.60
31/07/2015	294/15	1.54	2.45	3.07	3.56	3.62	3.54	3.49
28/08/2015	334/15	1.47	2.30	2.92	3.47	3.54	3.44	3.40
30/09/2015	379/15	1.44	2.19	2.79	3.42	3.50	3.42	3.39
	Low	1.31	2.02	2.60	3.16	3.28	3.23	3.21
	Average	1.46	2.32	2.96	3.51	3.59	3.52	3.49
	High	1.55	2.55	3.26	3.79	3.87	3.80	3.78

Semi-annual Treasury Report 2015/16

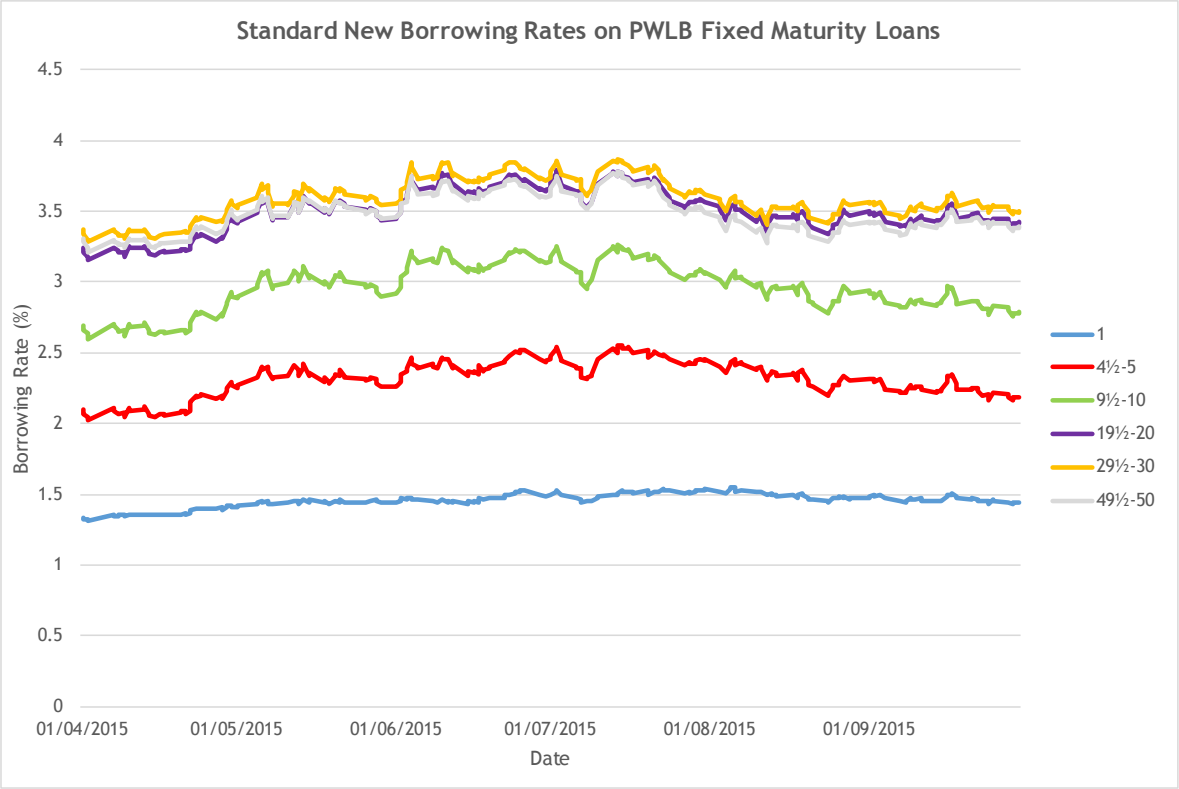

Table 3: PWLB Borrowing Rates - Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2014	127/15	1.63	2.11	2.68	3.00	3.22	3.32
30/04/2014	166/15	1.79	2.31	2.92	3.24	3.45	3.54
29/05/2014	204/15	1.78	2.30	2.93	3.26	3.45	3.53
30/06/2014	248/15	1.90	2.49	3.15	3.47	3.65	3.72
31/07/2014	294/15	1.96	2.50	3.09	3.39	3.57	3.63
28/08/2014	334/15	1.83	2.34	2.94	3.27	3.48	3.55
30/09/2014	379/15	1.76	2.23	2.82	3.19	3.43	3.51
	Low	1.60	2.06	2.62	2.94	3.16	3.26
	Average	1.84	2.37	2.99	3.31	3.51	3.59
	High	1.99	2.60	3.28	3.61	3.79	3.87

Semi-annual Treasury Report 2015/16

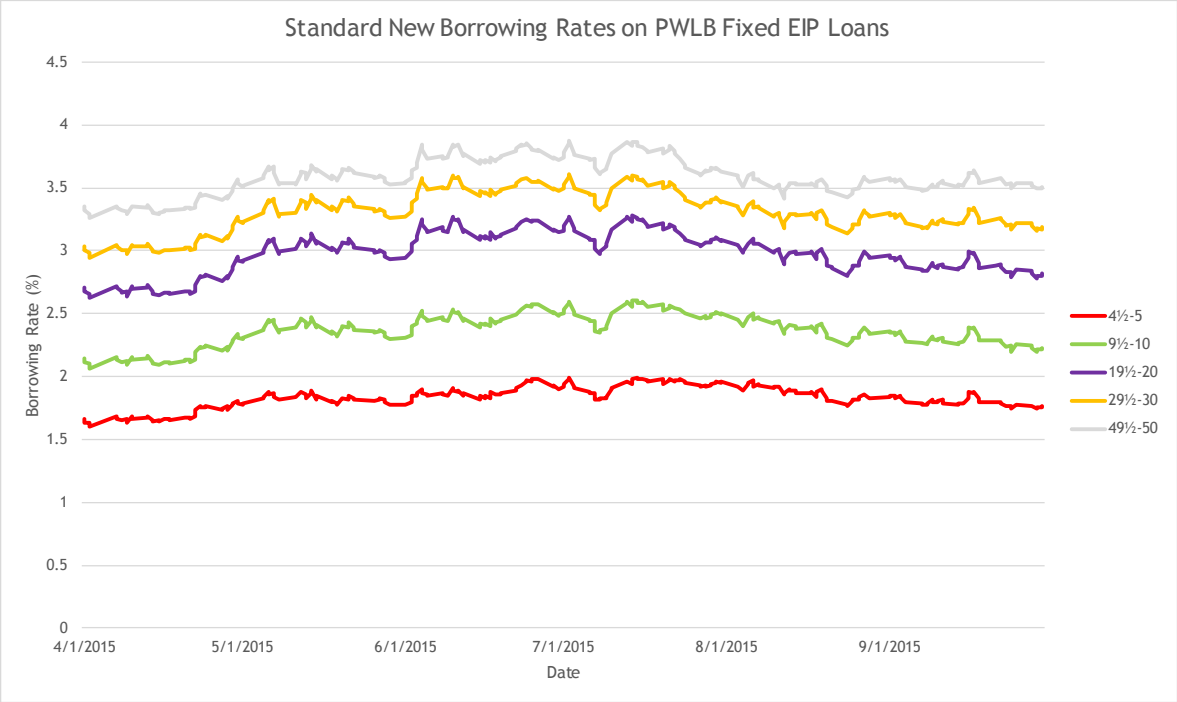

Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2015	0.62	0.63	0.66	1.52	1.53	1.56
30/04/2015	0.62	0.64	0.67	1.52	1.54	1.57
29/05/2015	0.62	0.65	0.68	1.52	1.55	1.58
30/06/2015	0.62	0.66	0.70	1.52	1.56	1.60
31/07/2015	0.62	0.66	0.72	1.52	1.56	1.62
28/08/2015	0.62	0.66	0.70	1.52	1.56	1.60
30/09/2015	0.66	0.67	0.76	1.56	1.57	1.66
Low	0.62	0.61	0.66	1.52	1.51	1.56
Average	0.63	0.65	0.70	1.53	1.55	1.60
High	0.66	0.69	0.78	1.56	1.59	1.68