Audit Committee	
Meeting Date	**9 December 2015**
Report Title	**Treasury Management Half Year Report**
Cabinet Member	**Cllr Duncan Dewar-Whalley, Cabinet Member for Finance**
SMT Lead	**Nick Vickers, Head of Finance**
Head of Service	**Nick Vickers, Head of Finance**
Lead Officer	**Olga Cole, Management Accountant**
Key Decision	**No**
Classification	**Reference number:**
Recommendations	To note the performance information in this report.

1 Purpose of Report and Executive Summary

1.1 The purpose of this report is to review the mid-year outturn position on treasury management transactions for 2015/16, including compliance with treasury limits and Prudential Performance Indicators. The report will go to Council on 27 January 2016.

1.2 The Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. In accordance with the Code of Practice members are informed of Treasury Management activities twice a year.

1.3 The approach to the use of the cash surplus continues to be highly risk averse both in terms of the counterparties the Council will use and the duration of deposits.

2. Background

Market Environment

2.1 The main external issue in the first six months of the year has been the diminishing likelihood of base rate increases in the UK. Arlingclose, the Council's treasury advisers, had a long-term position that rates would rise in May 2016. They have recently pushed this back to September 2016 and then very small step increases to 1.75% in September 2018. The longer for lower position reflects the underlying headwinds which the economy faces – in particular from the China slowdown and Eurozone stagnant economic growth. As the EU referendum and a possible Brexit come to dominate short-term horizons this will be an increasingly important issue for the Bank of England to factor into their thinking.

2.2 The annual rate for Consumer Price Inflation (CPI) has hovered around 0.0% to 0.1% after turning marginally negative in April. The Bank of England are forecasting inflation increasing to around 2% in the next 18 months. The index is bound to see an increase as the large falls in oil and petrol prices 12 months ago drop out – but underlying inflationary pressures do remain benign.

2.3 Equity markets performed poorly in the July to September quarter but have bounced back strongly since then. The volatility of equity markets means that we continue to avoid any products with an equity component.

Borrowing

2.4 The Council continues to be debt free. Borrowing will be undertaken if we proceed with the construction of a multi-storey car park in Sittingbourne.

Investments

2.5 The counterparties agreed by Cabinet and Council earlier this year when the 2015/16 Treasury Strategy was approved are:

Debt Management Office (Debt Management Account Deposit Facility) and Treasury Bills	Unlimited
Major UK banks / building societies. (Barclays, HSBC, Lloyds Banking Group, RBS Group, Santander UK, Nationwide, Standard Chartered) unsecured deposits	£3m
Svenska Handelsbanken	£3m
Leeds Building Society unsecured deposits	£1m
Close Brothers unsecured deposits	£1m
Small UK building societies unsecured deposits meeting Arlingclose preferred criteria	£250k each or £1m in aggregate
Major Overseas banks unsecured deposits (to be determined with Arlingclose)	£1m limit per bank
Short Term Money Market Funds	£1.5m each
CCLA LAMIT Property Fund	£1.5m in aggregate
Supranational bonds	£6m in aggregate
Corporate bond funds	£3m in aggregate
Absolute return funds	£3m in aggregate

2.6 For the major UK banks and building societies we have left the individual limit at £3m. This reflects that the underlying fundamentals of the banks have generally improved and the risk of unsecured deposits does seem to be relatively lower.

2.7 Returns or unsecured deposits remain low although very recently some 1% rates have become available for three month deposits.

2.8 The £1.5m investment in the CCLA Property Fund has produced good returns of 4.73% for the first six months. The Fund is now £500m and we will look to add to it in the 2016/17 Treasury Strategy.

2.9 Investments held at 30 September 2015 can be found in Appendix I.

2.10 The Council did not need to borrow to cover cash flow purposes in the period.

2.11 Interest income received for the first half of 2015 was £40,000 above the original budget of £42,700.

2.12 For the six months to 30 September 2015, the Council maintained an average sum invested of £34m compared with an original budget of £30m, and an average rate of return of 0.63% compared to a budget of 0.30%.

2.13 The results for the six months to 30 September 2015 show that the Council achieved 0.27% average return above the average 7 day London Interbank Bid Rate (LIBID) and 0.13% average return rate above the Bank of England Base Rate.

Compliance with Prudential Indicators

2.14 The Council can confirm that it has complied with its Prudential Indicators for 2015/16 which were set in February as part of the Council's Treasury Management Strategy Statement. The Council is required to report on the highly technical Prudential Indicators. There are no issues of concern to highlight with members.

2.15 Prudential and Treasury Management Indicators are set out in Appendix II.

3. Proposals

3.1 No changes are proposed at this stage.

4. Alternative Options

4.1 The Head of Finance will consider changes to the counterparty criteria with reference to the Council's agreed policy with regard to risk.

5. Consultation Undertaken

5.1 Consultation has been undertaken with Arlingclose.

6. Implications

Issue	Implications
Corporate Plan	No direct application.
Financial, Resource and Property	As detailed in the report.
Legal and Statutory	The Council has powers to both borrow funds to support its work and to invest and earn interest on funds available.
Crime and Disorder	Following CIPFA's Treasury Management Code of Practice is important to avoid involvement in potential fraud or money laundering.
Sustainability	None
Health and Wellbeing	None
Risk Management and Health and Safety	Risk is controlled through adherence to specific guidance included in CIPFA's Treasury Management Code of Practice. The principle of security of funds over-rides investment performance.
Equality and Diversity	None

7. Appendices

7.1 The following documents are to be published with this report and form part of the report.

- Appendix I: Investments as at 30 September 2015
- Appendix II: Prudential and Treasury Management Indicators

Appendix I

Investments as at 30 September 2015

Counterparty/ Country	Long-Term Rating (Moody's)	Balance Invested as at 30 September 2015 £'000
Lloyds TSB Bank Plc	A1	3,000
Standard Chartered Bank	Aa2	3,000
Santander UK Plc (Call Account)	A1	3,000
Svenska Handelsbanken	Aa2	3,000
Barclays Bank Plc	A2	3,000
Nordea Bank	Aa3	1,000
Debt Management Office	Aa1	3,000
Nationwide Building Society	A1	3,000
Total Banks and Building Society		**22,000**
Goldman Sachs Money Market Fund	Aaa-mf	1,500
Aberdeen Money Market Fund	Aaa-mf	1,500
Black Rock Money Market Fund	Aaa-mf	1,500
BNP Paribas Money Market Fund	Aaa-mf	1,500
Deutsche Money Market Fund	Aaa-mf	820
Morgan Stanley Money Market Fund	Aaa-mf	1,500
CCLA Property Fund	Aaa-mf	1,500
Total Money Market and Property Funds		**9,820**
Gross Total		**31,820**

The Ratings above are from Moody's Ratings. The Long Term Rating is the benchmark measure of probability of default. These ratings are shown for illustrative purposes only, as the Council uses the lowest rating across three agencies on which to base its decisions.

Investment Activity in 2015/16

Investments	Balance on 01/04/2015 £'000	Investments Made £'000	Investments Repaid £'000	Balance on 30/09/2015 £'000	Average Rate %	Average Life
Short Term Investments	22,300	114,940	(106,920)	30,320	0.63	58 days
Long Term Investments	1,500	0	0	1,500	4.73	6 years
Total Investments	**23,800**	**114,940**	**(106,920)**	**31,820**		
Increase/(Decrease) in Investments				8,020		

Appendix II

Prudential and Treasury Management Indicators

1. Background

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in local authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. Gross Debt and the Capital Financing Requirement (CFR)

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

Gross Debt and the Capital Financing Requirement	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Gross CFR	5,106	5,145	4,833	4,524
Less: Other Long Term Liabilities	(753)	(774)	(623)	(376)
Borrowing CFR	**4,353**	**4,371**	**4,210**	**4,148**
Less: Existing Profile of Borrowing	0	0	0	0
Cumulative Maximum External Borrowing Requirement.	**4,353**	**4,371**	**4,210**	**4,148**

The Authority has no external debt.

3. Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Total	2,219	1,103	15	15

Capital expenditure will be financed follows:

Capital Financing	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Capital receipts	528	30	0	0
Government Grants	1,270	1,058	0	0

Prudential and Treasury Management Indicators

Capital Financing	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Revenue contributions	421	15	15	15
Total Financing	**2,219**	**1,103**	**15**	**15**

4. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability, highlighting the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code. The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2014/15 Actual %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %
Total	**1.58**	**1.70**	**1.67**	**1.71**

5. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

Capital Financing Requirement	2014/15 Actual £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Total CFR	**5,106**	**5,145**	**4,833**	**4,524**

6. Actual External Debt

This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2015	£'000
Borrowing	0
Other Long-term Liabilities	753
Total	**753**

Prudential and Treasury Management Indicators

7. Incremental Impact of Capital Investment Decisions on Council Tax

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	**2014/15 Actual £**	**2015/16 Estimate £**	**2016/17 Estimate £**	**2017/18 Estimate £**
Increase / (Decrease) in Band D Council Tax	(0.01)	(0.01)	0.00	0.00

8. Authorised Limit and Operational Boundary for External Debt

The Authorised Limit sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council’s existing commitments, its proposals for capital expenditure and financing, and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	**2014/15 Estimate £’000**	**2015/16 Estimate £’000**	**2016/17 Estimate £’000**	**2017/18 Estimate £’000**
Borrowing	5,000	7,000	7,000	7,000
Other Long-term Liabilities	2,000	2,000	2,000	2,000
Total	**7,000**	**9,000**	**9,000**	**9,000**

The Operational Boundary links directly to the Council’s estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Prudential and Treasury Management Indicators

Operational Boundary for External Debt	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Borrowing	2,000	6,000	6,000	6,000
Other Long-term Liabilities	992	774	623	376
Total	**2,992**	**6,774**	**6,623**	**6,376**

The Head of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2015.

9. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Council has adopted the principles of best practice.

The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition on 22 February 2012.

10. Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums (i.e. fixed rate debt net of fixed rate investments).

Upper Limit for Interest Rate Exposure	Existing level at 30/09/15 %	2015/16 Approved Limit %	2016/17 Approved Limit %	2017/18 Approved Limit %
Interest on fixed rate borrowing	0	100	100	100
Interest on fixed rate investments	-50	-100	-100	-100
Upper Limited for Fixed Interest Rate Exposure	**-50**	**0**	**0**	**0**
Interest on variable rate borrowing	0	100	100	100
Interest on fixed rate borrowing	-50	-100	-100	-100
Upper Limited for Fixed Interest Rate Exposure	**-50**	**0**	**0**	**0**

As the Council has no borrowing, these calculations have resulted in negative figure.

Prudential and Treasury Management Indicators

11. Maturity Structure of Fixed Rate Borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

Maturity structure of fixed rate borrowing	Existing level at 30/09/15 %	Lower Limit for 2015/16 %	Upper Limit for 2015/16 %
Under 12 months	0	0	100
12 months and within 24 months	0	0	100
24 months and within 5 years	0	0	100
5 years and within 10 years	0	0	100
10 years and above	0	0	100

The Council does not have any external borrowing for capital purposes, and did not need to borrow for cash flow purposes during the six months to 30 September 2015.

12. Credit Risk

The Council considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- sovereign support mechanisms;
- credit default swaps (where quoted);
- share prices (where available);
- economic fundamentals, such as a country's net debt as a percentage of its GDP;
- corporate developments, news, articles, markets sentiment and momentum; and
- subjective overlay.

Prudential and Treasury Management Indicators

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

The Head of Finance confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

13. Principal Sums Invested for Periods Longer than over 364 days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

Upper Limit for total principal sums invested over 364 days	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
Total	9,000	9,000	9,000
Actual	1,500	-	-

14. Investment Benchmarking for the Six Months to 30 September 2015

Average Actual Return on Investments	Original Estimate Return on Investments	Average Bank Rate	Average 7 day LIBID Rate
0.63%	0.30%	0.50%	0.36%