Audit Committee	
Meeting Date	19 September 2018
Report Title	**Annual Treasury Management Report 2017/18**
Cabinet Member	Cllr Duncan Dewar-Whalley, Cabinet Member for Finance & Performance
SMT Lead	Nick Vickers, Chief Financial Officer
Head of Service	Nick Vickers, Chief Financial Officer
Lead Officer	Phil Wilson, Financial Services Manager
Key Decision	No
Classification	Open

Recommendations	1. Approve the Treasury Management stewardship report for 2017/18.
	2. Approve the Prudential and Treasury Management Indicators within the report.

1. Purpose of Report and Executive Summary

1.1 The Council's Treasury Management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annual Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of Treasury Management activities at least twice a year.

1.2 CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Code will be incorporated into the 2019/20 Treasury Management Strategy and subsequent monitoring. The 2019/20 Budget Report to Cabinet will include a Capital Strategy to meet the requirements of the revised Codes.

1.3 In February 2018 the MHCLG (Ministry of Housing, Communities and Local Government) published revised Guidance on Local Government and Investments and Statutory Guidance on Minimum Revenue Provision (MRP) and this will be incorporated into the MRP Policy which forms part of the Budget Report to Cabinet.

1.4 Treasury Management is defined as "the management of the local Council'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". No Treasury Management activity is without risk; the effective identification and management of risk are integral to the Council's Treasury Management objectives.

1.5 Towards the end of 2017/18 operational responsibility for the daily treasury management duties was passed to the Investments Section of the Kent County Council Finance Department in order to cover a maternity leave. KCC Finance in undertaking this work have to comply with this Council's Treasury Management Strategy. Overall responsibility for Treasury Management remains with the Council.

1.6 This report:

- is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code;
- details the implications of treasury decisions and transactions;
- gives details of the outturn position on Treasury Management transactions in 2017/18; and
- confirms compliance with Treasury limits and Prudential Indicators.

1.7 This report will be submitted to Council on 10 October 2018.

2. Background

Borrowing Requirement and Debt Management

2.1 The overall borrowing position is summarised below:

	Balance on 31/3/2017	Movement in Year	Balance on 31/3/2018
	£'000	**£'000**	**£'000**
Capital Financing Requirement	4,530	+7,981	12,511
Other Long Term Liabilities (cost of leases for equipment)	(384)	+244	(140)
Borrowing Capital Financing Requirement	**4,146**	**+8,225**	**12,371**

2.2 Where capital expenditure is to be financed in future years by charges to revenue as assets are used by the Council, the expenditure results in an increase in the Capital Financing Requirement (CFR), a measure of the capital expenditure incurred historically by the Council that has yet to be financed.

2.3 The reason for the increase in the CFR in 2017/18 is due to the capital expenditure on the construction of the Princes Street Retail Park and other works undertaken as part of the Sittingbourne Town Centre regeneration project and which were financed from internal borrowing. The CFR will be reduced in the future by contributions from rental income.

2.4 The Council undertook no external borrowing in the year.

Investment Activity

2.5 The Council holds significant investment funds, representing income received in advance of expenditure plus balances and reserves held. During 2017/18, the Council held average daily cash balances of £36m, which is a decrease of £2m on the previous year despite the level of expenditure on Sittingbourne Town Centre.

2.6 The Council's budgeted investment income for 2017/18 was £110,480 and the actual income received was £261,270, of which £138,340 was from the Council's long-term investment in the CCLA Property Fund, £76,220 was from the Council's short-term investments and £46,710 was from the Council's cash and cash equivalent investments. The CCLA Property Fund investment has been a highly successful one for the Council as UK Commercial Property has continued to perform well.

2.7 The table below summarises the Council's investment portfolio at 31 March 2018. All investments made were in line with the Council's approved credit rating criteria at the time of placing the investment, and still met those criteria at 31 March 2018.

Counterparty **(MMF = Money Market Funds)**	**Long-Term Rating**	**Balance Invested at 31 March 2018** **£'000**
Lloyds Bank (fixed term for 1 year)	Aa3	3,000
HSBC Bank (90 day notice)	Aa3	3,000
Sub Total Short-Term Investments		**6,000**
Invesco MMF	Aaam	3,000
BNP Paribas MMF	Aaa-mf	3,000
Black Rock MMF	Aaa-mf	1,815
Amundi MMF	Aaam	3,000
Sub Total Cash & Cash Equivalents		**10,815**
CCLA Property Fund	unrated	3,000
Sub Total Long-Term Investments		**3,000**
Total		**19,815**

2.8 The ratings above are from Moody's credit rating agency. A description of the grading is provided below:

- Aaa-mf, Aaam: Funds have very strong ability to meet the dual objectives of providing liquidity and preserving capital.
- Aa3: Investments are judged to be of a high quality and are subject to very low credit risk.

2.9 The reduction is short-term investments in 2017/18 is due to the financing of the Council's capital programme.

2.10 The deposits for the year are summarised below:

Investments	**Balance on 31/03/17**	**Investments Made**	**Maturities**	**Balance on 31/03/18**	**Average Rate**
	£'000	**£'000**	**£'000**	**£'000**	**%**
Short Term Investments and Cash and Cash Equivalents	26,512	164,517	(174,214)	16,815	0.36
Long Term Investments	3,000	0	0	3,000	4.71
TOTAL INVESTMENTS	**29,512**	**164,517**	**(174,214)**	**19,815**	
Increase/ (Decrease) in Investments				(9,697)	

The £3m long-term investment shown in the table above is the Council's investment in the CCLA Property Fund.

2.11 The Council's investment strategy has two overriding principles:

- minimising the cost to the revenue budget - given the continued reductions in local government financing there is no scope within the revenue budget to meet debt charge costs. If the Council incurred debt charge costs then, unless the investment generated sufficient income to cover these costs, the Council may have to reduce services to fund the costs. In the case of the Sittingbourne Town Centre investment all the capital financing costs will be funded from rental income; and

- strategic impact - if the Council is going to invest in property it needs to support the Council's wider objectives around regeneration of the Council and creating new employment. This means there needs to be additionality in-terms of the wider economic benefits e.g. higher Business Rates.

2.12 In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds, overnight deposits and the use of call accounts.

2.13 The Council sought to optimise returns commensurate with its objectives of security and liquidity. Short-term money market rates remained at very low levels as did rates for short-term bank deposits.

2.15 The criteria applied by the Chief Financial Officer for the approval of a counter party for deposits are:

- Credit rating - a minimum long-term of A-;
- Credit default swaps;
- Share price;
- Reputational issues;
- Exposure to other parts of the same banking group; and
- Country exposure.

2.16 The investments permissible by the 2017/18 Treasury Strategy were:

Investment	Limit	Used in 2017/18?
Debt Management Office (Debt Management Account Deposit Facility) and Treasury Bills	Unlimited	Yes
Major UK banks / building societies. (Barclays, HSBC, Lloyds Banking Group, RBS Group, Santander UK, Nationwide, Standard Chartered) unsecured deposits	£3m	Barclays, HSBC, Nationwide, Lloyds Banking Group, Santander UK
Svenska Handelsbanken unsecured deposits	£3m	Yes
Leeds Building Society unsecured deposits	£1.5m	Yes
Close Brothers unsecured deposits	£1.5m	Yes
Major overseas banks unsecured deposits (to be determined based upon Arlingclose advice) Netherlands: Bank Nederlande Gemeeten, Rabobank Singapore: OCBC, UOB, DBS Sweden: Nordea Bank Denmark: Danske Bank USA: JP Morgan Chase Australia: Australian and New Zealand Banking Group, Commonwealth Bank of Australia, National Australian Bank Ltd, Westpac Banking Corp Canada: Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada, Toronto Dominion Bank	£1.5m limit per bank, £3m country limit	No
Short Term Money Market Funds	£3m each	Yes
Cash Plus Funds and Short Dated Bond Funds	£3m each	No
Multi Asset Income Funds	£3m each	No

Investment	Limit	Used in 2017/18?
CCLA LAMIT Local Authority Property Fund	£3m	Yes
Supranational Bonds	£3m in aggregate	No
Corporate Bond Funds and Corporate Bonds	£3m in aggregate	No
Covered Bonds	£9m in aggregate with £3m limit per bank	No
Absolute return funds	£3m in aggregate	No
Equity income funds	£3m in aggregate	No

2.17 The maximum permitted duration for deposits is 13 months. The Chief Financial Officer in consultation with the Cabinet Member for Finance & Performance may consider longer duration. Bonds can be purchased with a maximum duration of five years. The fixed term deposit for a year with Lloyds was the longest duration of any of the Council's investments.

External Context

2.18 The Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.25% in November 2017 to 0.5%. It was significant in that it was the first rate hike in ten years. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. On 2 August 2018, the Bank of England raised the base rate from 0.5% to 0.75%. These increases have not been reflected in higher returns on the Council's bank deposits. The consensus is that whilst Bank Rate will rise it will be slow and not to pre-2008 levels.

2.19 In March, following Arlingclose's advice, the Council removed RBS plc and National Westminster Bank from its counterparty list. This did not reflect any change to the creditworthiness of either bank, but a tightening in Arlingclose's recommended minimum credit rating criteria to A- from BBB+ for 2018/19. The current long-term ratings of RBS and NatWest do not meet this minimum criterion, although if following ring-fencing NatWest is upgraded, the bank would be reinstated on the Council's lending list.

2.20 The Council has seen a dramatic change over the last eight years in how it is funded. The Revenue Support Grant will disappear completely in 2020/21, and in its place the Council has become reliant on income sources that are related in full or in some part to issues over which it has control. This sets the pattern for how councils will be funded in the future and the Council will continue down the path of financial self-sufficiency.

Compliance with Prudential Indicators

2.21 The Council has complied with its Prudential Indicators for 2017/18 which were set as part of the Treasury Management Strategy agreed by Council in February 2017.

2.22 In Appendix I the outturn position for the year against each Prudential Indicator is set out.

Treasury Advisers

2.23 Arlingclose has been the Council's treasury advisers since May 2009. Following a tendering process, Arlingclose were reappointed in 2015. Officers of the Council meet with them regularly and high quality and timely information is received from them.

MIFID II

2.24 As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3 January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved. The Council has met the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. The Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

3. Proposal

3.1 Members are asked to approve the report.

4. Alternative Proposals

4.1 No alternative proposals have been considered and compliance with the CIPFA Code is mandatory.

5. Consultation Undertaken

5.1 Arlingclose have been consulted.

6. Implications

Issue	**Implications**
Corporate Plan	Supports delivery of the Council's objectives.
Financial, Resource and Property	As detailed in the report
Legal, Statutory and Procurement	Need to comply with CLG guidance on treasury management.
Crime and Disorder	Not relevant to this report
Environment and Sustainability	Not relevant to this report
Health and Wellbeing	Not relevant to this report
Risk Management and Health and Safety	Not relevant to this report
Equality and Diversity	Not relevant to this report
Privacy and Data Protection	Not relevant to this report

7. Appendices

7.1 Appendix I: Treasury Management and Prudential Indicators

8. Background Papers

None

Treasury Management and Prudential Indicators for 2017/18

1. Introduction

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

This report compares the approved indicators with the outturn position for 2017/18. Actual figures have been taken from or prepared on a basis consistent with, the Council's Statement of Accounts

Capital Expenditure: The Council's capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	**2017/18 Estimate**	**2017/18 Actual**	**Difference**
	£'000	**£'000**	**£'000**
Total Capital Expenditure	**12,086**	**11,491**	**(595)**
Capital Receipts	529	70	(459)
Grants and other contributions	3,885	2,904	(981)
Reserves	389	241	(148)
Internal Borrowing	7,283	8,276	993
Total Financing	**12,086**	**11,491**	**(595)**

Treasury Management and Prudential Indicators for 2017/18

Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31/03/18 Estimate	31/03/18 Actual	Difference
	£'000	**£'000**	**£'000**
Total CFR	13,069	12,511	(558)
Less: Other Long Term Liabilities	(200)	(140)	60
Borrowing CFR	**12,869**	**12,371**	**(498)**
Less: External Borrowing	0	0	0
Cumulative Maximum External Borrowing Requirement	**12,869**	**12,371**	**(498)**

External borrowing: as at 31 March 2018 the Council did not have any external borrowing.

Operational Boundary for External Debt: The Operational Boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary and Total Debt	31/03/18 Boundary	31/03/18 Actual Debt	Complied
	£'000	**£'000**	
Borrowing	55,000	0	✓
Other long-term liabilities	41	140	x
Total Operational Boundary	**55,041**	**140**	✓

Treasury Management and Prudential Indicators for 2017/18

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 Council can legally owe. The Authorised Limit provides headroom over and above the Operational Boundary for unusual cash movements.

Authorised Limit and Total Debt	31/03/18 Boundary	31/03/18 Actual Debt	Complied
	£'000	£'000	
Borrowing	60,000	**0**	✓
Other long-term liabilities	2,000	**140**	✓
Total Authorised Limit	**62,000**	**140**	✓

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2017/18.

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	31/03/18 Estimate	31/03/18 Actual	Difference
	%	%	%
General Fund Total	2.88	0.04	(2.84)

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2012.

Treasury Management and Prudential Indicators for 2017/18

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net interest payable was:

Interest Rate Exposures	31/03/18 Actual	2017/18 Limit	Complied
	%	%	
Interest on fixed rate investments	-21	-100	✓
Interest on variable rate investments	-79	-100	✓

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

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

	31/03/18 Actual	Upper Limit	Lower Limit	Complied
	%	%	%	
Under 12 months	0	100	0	✓
12 months and within 24 months	0	100	0	✓
24 months and within 5 years	0	100	0	✓
5 years and within 10 years	0	100	0	✓
10 years and above	0	100	0	✓

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

	2017/18
	£'000
Actual principal invested beyond year end	3,000
Limit on principal invested beyond year end	10,000
Complied	✓

Appendix I

Treasury Management and Prudential Indicators for 2017/18

Investment Benchmarking

Average Actual Return on investments 2017/18	Original Estimate Return on Investments 2017/18	Average Bank Rate 2017/18	Average 7 day LIBID Rate 2017/18
0.72%	0.31%	0.35%	0.31%

(The London Interbank Bid Rate (LIBID) is a bid rate; the rate at which a bank is willing to borrow from other banks)