Audit Committee		Agenda Item: 6
Meeting Date	28 November 2018	
Report Title	Treasury Management Half Year Report 2018/19	
Cabinet Member	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. To note the performance information in this report. 2. To approve the prudential and treasury management indicators within the 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 2018/19, including compliance with treasury limits and Prudential and Treasury Performance Indicators. The report will go to Council on 9 January 2019.

1.2 The Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice 2011 Edition, which requires the Council to approve treasury management semi-annual and annual reports.

1.3 The Council's treasury management strategy for 2018/19 was approved at a meeting on 21 February 2018. The Council has 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. The successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy.

1.4 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England the Ministry for Housing, Communities and Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.

1.5 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council will be producing its Capital Strategy for approval by full Council in February 2019.

2. Background

Market Environment

2.1 UK Consumer Price Inflation (CPI) for August rose to 2.7% per annum, above the consensus forecast and that of the Bank of England's in its August Inflation Report, as the effects of sterling's large depreciation in 2016 began to fade.

2.2 The Bank of England made no change to monetary policy at its meetings in May and June, this was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%. Since then, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon.

2.3 With regard to the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018. The Council's treasury advisor Arlingclose will henceforth provide ratings which are specific to deposits, rather than provide general issuer credit ratings.

Borrowing

2.4 The Council continues to be debt free. Council has agreed to borrow up to £28 to cover Sittingbourne Town Centre and an additional £30m subject to business cases to be agreed by Cabinet. The aim is to use this permission strategically to drive forward regeneration of the borough and produce higher investment returns for the Council. Given the underlying financial position of the Council debt interest costs need to be met through rental income not from the base budget. The Council will also internally borrow to minimise debt charge costs.

Investments

2.5 The counterparties agreed by Cabinet and Council earlier this year when the 2018/19 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 unsecured deposits	£3m
Leeds Building Society unsecured deposits	£1.5m

Close Brothers unsecured deposits	£1.5m
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
Money Market Funds	£3m each
Cash Plus Funds and Short Dated Bond Funds	£3m each
Multi Asset Income Funds	£3m each
CCLA LAMIT Local Authority Property Fund	£3m
Supranational Bonds	£3m in aggregate
Corporate Bond Funds and Corporate Bonds	£3m in aggregate
Non treasury investments	To be agreed on a case by case basis
Covered Bonds	£9m in aggregate with £3m limit per bank
Absolute return funds	£3m in aggregate
Equity income funds	£3m in aggregate

2.6 Investments held at 30 September 2018 can be found in Appendix I.

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

2.8 Interest income received for the first half of 2018/19 was £133,580.

2.9 For the six months to 30 September 2018, the Council maintained an average sum invested of £27.757m compared with an original budget of £21.061m, and an average rate of return of 0.96% compared to a budget of 0.47%.

2.10 The results for the six months to 30 September 2018 show that the Council achieved 0.52% average return above the average 7 day London Interbank Bid Rate (LIBID) and 0.38% average return rate above the average Bank of England Base Rate.

2.11 The Council has £3m invested in an externally managed property fund which is the CCLA fund which generated an average total return of 4.34%, comprising a £65k income return. Since this fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. In light of its performance and the Council's latest cash flow forecasts, investment in this fund has been maintained.

Compliance with Prudential Indicators

2.12 The Council can confirm that it has complied with its Prudential Indicators for 2018/19 which were set in February 2018 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. The indicators are based on approved commitments and the current budget.

2.13 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 Chief Financial Officer 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	Supports delivery of the Council's objectives.
Financial, Resource and Property	As detailed in the report.
Legal, Statutory and Procurement	Need to comply with MHCLG guidance on treasury management.
Crime and Disorder	Following CIPFA's Treasury Management Code of Practice is important to avoid involvement in potential fraud or money laundering.
Environment and Sustainability	Not relevant to this report
Health and Wellbeing	Not relevant to this report
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	Not relevant to this report

Issue	Implications
Privacy and Data Protection	Not relevant to this report

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 2018
- Appendix II: Prudential and Treasury Management Indicators

8. Background Papers

None

Appendix I

Investments as at 30 September 2018

Counterparty	Long-Term Rating	Balance Invested at 30 September 2018
		£'000
CCLA Property Fund		**3,000**
Money Market Funds		
Invesco Money Market Fund	AAAm	3,000
Deutsche Money Market Fund	AAAm	2,400
Goldman Sachs Money Market Fund	AAAm	3,000
Black Rock Money Market Fund	AAAm	3,000
BNP Paribas Money Market Fund	AAAm	3,000
Amundi Money Market Fund	AAAm	3,000
Morgan Stanley Money Market Fund	AAAm	379
SSGA Money Market Fund	AAAm	3,000
Total Money Market Funds		**20,779**
Total		**23,779**

The Ratings above are from Standard & Poor's (S&P) 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 2018/19

Investments	Balance on 01/04/2018	Investments Made	Investments Repaid	Balance on 30/09/2018	Average Rate
	£'000	£'000	£'000	£'000	%
Short Term Investments and Cash and Cash Equivalents	16,815	90,787	(86,823)	20,779	0.55
Long Term Investments	3,000	0	0	3,000	4.34
Total Investments	**19,815**	**90,787**	**(86,823)**	**23,779**	
Increase in Investments				3,964	

Appendix I

Investments as at 30 September 2018

Non-Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return. The Council holds £3m of such investments in directly owned property.

These investments are expected to generate £0.2m of investment income for the Council after taking account of direct costs, representing a rate of return of 5.7%.

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	**2017/18 Actual £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**
Gross CFR	12,511	41,572	41,444	40,299
Less**:** Other Long Term Liabilities	(140)	(41)	(24)	(19)
Borrowing CFR	**12,371**	**41,531**	**41,420**	**40,280**
Less**:** Existing Profile of Borrowing	0	0	0	0
Cumulative Maximum External Borrowing Requirement.	**12,371**	**41,531**	**41,420**	**40,280**

The Council does not have any external borrowing for capital purposes.

Appendix II

Prudential and Treasury Management Indicators

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 and Financing	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Total Expenditure	**11,491**	**33,717**	**2,937**	**2,018**
Capital receipts	70	0	0	0
Grants and other contributions	2,904	1,765	1,765	1,765
Reserves	241	118	58	228
Internal borrowing	8,276	5,312	1,114	25
External borrowing	0	26,522	0	0
Total Financing	**11,491**	**33,717**	**2,937**	**2,018**

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	2017/18 Actual %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Total	**0.04**	**7.01**	**6.63**	**5.66**

Prudential and Treasury Management Indicators

5. 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 31/03/2018	**£'000**
Borrowing	0
Other Long-term Liabilities	140
Total	**140**

6. 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).

At the Council meeting on 15 February 2017, Members approved an additional £30m borrowing to allow for funding to be provided up a maximum borrowing of £65m (minute 1197/02/2017).

Authorised Limit for External Debt	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**
Borrowing	60,000	60,000	60,000
Other Long-term Liabilities	2,000	2,000	2,000
Total	**62,000**	**62,000**	**62,000**

Prudential and Treasury Management Indicators

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.

Operational Boundary	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Borrowing	55,000	55,000	55,000
Other Long-term Liabilities	41	24	19
Total Debt	**55,041**	**55,024**	**55,019**

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2018.

7. 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 30/09/18	2018/19 Approved Limit	2019/20 Approved Limit	2020/21 Approved Limit
Interest on fixed rate borrowing	0%	100%	100%	100%
Interest on fixed rate investments	-0%	-100%	-100%	-100%
Upper Limit for Fixed Interest Rate Exposure	**-0%**	**0%**	**0%**	**0%**
Interest on variable rate borrowing	0%	100%	100%	100%
Interest on variable rate investments	-100%	-100%	-100%	-100%
Upper Limit for Variable Interest Rate Exposure	**-100%**	0%	0%	0%

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

Prudential and Treasury Management Indicators

8. 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 30/09/18 %	Lower Limit for 2018/19 %	Upper Limit for 2018/19 %	Complied
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 2018.

9. 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 Chief Financial Officer confirms that there were no breaches to counterparty limits or credit ratings at the time of placing investments.

10. 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 Council having to seek early repayment of the sums invested.

Total Principal Sums Invested Over 364 Days	**2018/19 £'000**
Upper Limit Estimate	10,000
Actual	3,000
Complied	√

11. Investment Benchmarking for the six months to 30 September 2018

Average Actual Return on Investments	**Original Estimate Return on Investments**	**Average Bank Base Rate**	**Average 7 day LIBID Rate**
0.96%	0.47%	0.58%	0.44%