Audit Committee		Agenda Item: 5
Meeting Date	30 November 2016	
Report Title	Treasury Management Half Year Report 2016/17	
Cabinet Member	Duncan Dewar-Whalley, Cabinet Member for Finance & Performance	
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	Open	
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 2016/17, including compliance with treasury limits and Prudential Performance Indicators. The report will go to Council on 25 January 2017.

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.

2. Background

Market Environment

2.1 The main external issue in the first six months of the year has been the Bank of England's decision in August to reduce the base rate to 0.25% and further gilt and corporate bond purchases (Quantative Easing) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. These post Brexit vote actions were made to pre-empt a slowdown in the economy but second quarter growth of 0.5% was better than expected. The reduction in base rate has led to further reduction in the rates offered by banks for deposits and from money market funds. The Council currently has no exposure to equity markets which have performed strongly in the first half of the year.

2.2 Inflation is expected to pick up due to a rise in import prices, dampening real wage growth and real investment returns. The August Quarterly Inflation Report from the Bank of England forecasts a rise in CPI to 0.9% by the end of calendar 2016 and thereafter a rise closer to the Bank's 2% target over the coming year, as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies.

2.3 Some of the UK's largest property pooled fund providers closed their funds in the immediate aftermath of the Brexit vote and the CCLA LAMIT Property Fund, which the Council invests in, wrote down capital values by 4%. There has since the initial Brexit reaction capital values have reduced marginally but it was already widely forecast that UK Commercial Property returns in the next few years would be driven by income returns. Fidelity are forecasting returns for UK Commercial Property of 6-7% per annum for the next five years. The Council added £1.5m to its investment in the CCLA Fund in September.

<u>Borrowing</u>

2.4 The Council continues to be debt free. On 16 March Council agreed to a variation in the Budget Framework permitting the Council to borrow up to £30m subject to individual business cases to 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 look to internally borrow to minimise debt charge costs.

<u>Investments</u>

2.5 The counterparties agreed by Cabinet and Council earlier this year when the 2016/17 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	£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	£1.5m limit per bank, £3m country limit

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	
Short Term Money Market Funds	£3m each
CCLA LAMIT Local Authority Property Fund	£3m
Supranational Bonds	£6m in aggregate
Corporate Bond funds and Corporate Bonds	£3m in aggregate
Covered Bonds	£9m in aggregate with £3m limit per bank
Absolute return funds	£3m in aggregate
Equity income funds	£3m in aggregate
Cash Plus Funds and Short Dated Bond Funds	£1.5m each, £3m in aggregate

2.9 Investments held at 30 September 2016 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 2016/17 was £126,280 which is £75,930 above the original budget of £50,350.

2.12 For the six months to 30 September 2016, the Council maintained an average sum invested of £35m compared with an original budget of £33m, and an average rate of return of 0.71% compared to a budget of 0.30%.

2.13 The results for the six months to 30 September 2016 show that the Council achieved 0.43% average return above the average 7 day London Interbank Bid Rate (LIBID) and 0.29% average return rate above the average Bank of England Base Rate

Compliance with Prudential Indicators

2.14 The Council can confirm that it has complied with its Prudential Indicators for 2016/17 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. The indicators are based on approved commitments and the current budget. They will be updated to reflect the Sittingbourne Town Centre redevelopment proposals in the Investment Strategy for 2017/18 to Council in February 2017.

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 2016
- Appendix II: Prudential and Treasury Management Indicators

8. Background Papers

None

Appendix I

Investments as at 30 September 2016

Counterparty	**Long-Term Rating (Moody's)**	**Balance Invested as at 30 September 2016 £'000**
Lloyds TSB Bank Plc	A1	3,000
Santander UK Plc (180 Day Notice Account)	A1	3,000
Svenska Handelsbanken	Aa2	3,000
Nationwide Building Society	Aa3	3,000
HSBC Bank (90 Day Notice Account)	Aa2	3,000
Total Banks and Building Society		**15,000**
Goldman Sachs Money Market Fund	Aaa-mf	3,000
Aberdeen Money Market Fund	Aaa-mf	3,000
Black Rock Money Market Fund	Aaa-mf	3,000
BNP Paribas Money Market Fund	Aaa-mf	3,000
Deutsche Money Market Fund	Aaa-mf	1,520
Morgan Stanley Money Market Fund	Aaa-mf	3,000
CCLA Property Fund		3,000
Total Money Market and Property Funds		**19,520**
Gross Total		**34,520**

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.

<u>Investment Activity in 2016/17</u>

Investments	**Balance on 01/04/2016 £'000**	**Investments Made £'000**	**Investments Repaid £'000**	**Balance on 30/09/2016 £'000**	**Average Rate %**	**Average Life**
Short Term Investments	25,375	110,405	(104,260)	31,520	0.71	109 days
Long Term Investments	1,500	1,500	0	3,000	4.49	6 years
Total Investments	**26,875**	**111,905**	**(104,260)**	**34,520**		
Increase/(Decrease) in Investments				7,645		

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	**2015/16 Actual £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
Gross CFR	4,770	4,374	4,000	3,619
Less: Other Long Term Liabilities	(550)	(382)	(181)	(24)
Borrowing CFR	**4,220**	**3,992**	**3,819**	**3,595**
Less: Existing Profile of Borrowing	0	0	0	0
Cumulative Maximum External Borrowing Requirement.	**4,220**	**3,992**	**3,819**	**3,595**

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

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	**2015/16 Actual £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
Total Expenditure	**2,309**	**2,739**	**50**	**15**
Capital receipts	127	605	35	0
Grants	1,436	2,104	0	0
Revenue contributions	746	30	15	15
Total Financing	**2,309**	**2,739**	**50**	**15**

Prudential and Treasury Management Indicators

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	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Total	1.51	1.58	1.66

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	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Total Capital Financing Requirement	4,770	4,374	4,000	3,619

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 31/03/2016	£'000
Borrowing	0
Other Long-term Liabilities	550
Total	**550**

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	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Increase / (Decrease) in Band D Council Tax	(0.04)	0.00	0.00

Prudential and Treasury Management Indicators

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).

At the Council meeting on 16 March 2016, Members approved a change to the budget framework to allow for funding to be provided up a maximum borrowing of £30m (minute 607/03/2016).

Authorised Limit for External Debt	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
Borrowing	35,000	35,000	35,000
Other Long-term Liabilities	2,000	2,000	2,000
Total Debt	**37,000**	**37,000**	**37,000**

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.

Operational Boundary	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
Borrowing	30,000	30,000	30,000
Other Long-term Liabilities	382	181	24
Total Debt	**30,382**	**30,181**	**30,024**

The Head of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2016.

Prudential and Treasury Management Indicators

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 30/09/16 %**	**2016/17 Approved Limit %**	**2017/18 Approved Limit %**	**2018/19 Approved Limit %**
Interest on fixed rate borrowing	0	100	100	100
Interest on fixed rate investments	-48	-100	-100	-100
Upper Limit for Fixed Interest Rate Exposure	**-48**	**0**	**0**	**0**
Interest on variable rate borrowing	0	100	100	100
Interest on variable rate investments	-52	-100	-100	-100
Upper Limit for Variable Interest Rate Exposure	**-52**	**0**	**0**	**0**

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

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 30/09/16 %**	**Lower Limit for 2016/17 %**	**Upper Limit for 2016/17 %**
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

Prudential and Treasury Management Indicators

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 2016.

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.

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.

Total Principal Sums Invested Over 364 Days	**2016/17 £'000**	**2017/18 £'000**	**2018/19 £'000**
Upper Limit Estimate	9,000	10,000	10,000
Actual	3,000	-	-

Appendix II

Prudential and Treasury Management Indicators

14. Investment Benchmarking for the six months to 30 September 2016

Average Actual Return on Investments	Original Estimate Return on Investments	Average Bank Rate	Average 7 day LIBID Rate
0.71%	0.30%	0.42%	0.28%