Council	Agenda Item:
Meeting Date	**18 October 2017**
Report Title	**Annual Treasury Management Report 2016/17**
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	**Olga Cole, Management Accountant**
Key Decision	**No**
Classification	**Open**
Forward Plan	**Reference number**

Recommendations	1. To approve the Treasury Management stewardship report for 2016/17.
	2. To 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 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".

1.3 Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

1.4 This report:

- is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
- details the implications of treasury decisions and transactions;

- gives details of the outturn position on treasury management transactions in 2016/17; and
- confirms compliance with Treasury limits and Prudential Indicators.

1.5 This report was submitted to the Audit Committee on 13 September 2017.

2. Background

Borrowing Requirement and Debt Management

2.1 The overall borrowing position is summarised below:

	Balance on 31/3/2016 £000's	Movement in Year £000's	Balance on 31/3/2017 £000's
Capital Financing Requirement	4,770	-240	4,530
Other Long Term Liabilities (cost of leases for equipment)	-550	+166	-384
Borrowing Capital Financing Requirement	**4,220**	**-74**	**4,146**

2.2 The Council undertook no borrowing in the year but full Council did agree in February 2017 that the Council could borrow externally up to £60m to fund regeneration activity. The funding of the Sittingbourne Town Centre regeneration project and the Sittingbourne Multi-Storey car park will be the first call on borrowing.

2.3 In 2016/17 all borrowing was internally financed.

Investment Activity

2.4 The Council holds significant investment funds, representing income received in advance of expenditure plus balances and reserves held. During 2016/17, the Council's investment balances ranged between £28 and £50 million due to timing differences between income and expenditure. The Council held average daily cash balances of £38m during the year - this is an increase of £2m on the previous year. The year-end investment position is shown below.

Counterparty	Long-Term Rating	Balance Invested at 31 March 2017 £'000
Svenska Handelsbanken	Aa2	3,000
Santander Bank	Aa3	3,000
Lloyds Bank	A1	3,000
Nationwide Building Society	Aa3	3,000
HSBC Bank	Aa2	3,000
Leeds Building Society	A2	1,500
Close Brothers	Aa3	1,500
BNP Paribas Money Market Fund	Aaa-mf	3,000
Morgan Stanley Money Market Fund	Aaa-mf	2,520
Black Rock Money Market Fund	Aaa-mf	3,000
CCLA Property Fund		3,000
Total		**29,520**

2.5 The Communities and Local Government's (CLG's) Guidance on Investments, revised during 2009/10, reiterated security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance became operative on 1 April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised CIPFA Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three rating agencies – Fitch, Moody's and Standard & Poor's – be taken into account and the lowest rating be used.

2.6 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.

2.7 The investments permissible by the 2016/17 Treasury Strategy were:

Investment Instruments (in sterling)	**Limits and Maturity dates**
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 Svenska Handelsbanken unsecured deposits	£3m £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	£1.5m limit per bank, £3m country limit

Investment Instruments (in sterling)	Limits and Maturity dates
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

2.8 The maximum 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.

External Context

2.9 UK inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However the sharp fall in the Sterling exchange rate had an impact on import prices which, together with rising energy prices, resulted in CPI rising from 0.3% year on year in April 2016 to 2.3% year onyear in March 2017.

2.10 In August 2016 the Bank of England's Monetary Policy Committee (MPC) cut the Bank Rate to 0.25% and embarked on further gilt and corporate bond purchases as well as provide cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

2.11 Despite growth forecasts being downgraded, economic activity was fairly positive and GDP grew 0.6%, 0.5% and 0.7% in the second, third and fourth calendar quarters of 2016. The labour market also proved resilient, with the International Labour Organisation unemployment rate dropping to 4.7% in February, its lowest level in 11 years.

2.12 Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. After September there was a reversal in longer-dated gilt yields which moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016.

2.13 Money market rates for overnight and one week periods remained low since Bank Rate was cut in August. 1 and 3 month LIBID rates averaged 0.36% and 0.47% respectively during 2016/17. Rates for 6 and 12 months increased between August and November, only to gradually fall back to August levels in March, they averaged 0.6% and 0.79% respectively during 2016/17.

2.14 On the advice of Arlingclose, new investments with Deutsche Bank and Standard Chartered Bank were suspended in March 2016 due to the banks' relatively higher credit default swap (CDS) levels and disappointing 2015 financial results. The Council's deposits with Standard Chartered matured in May 2016. Standard Chartered was reintroduced to the counterparty list in March 2017 following its strengthening financial position, but Deutsche Bank was removed altogether from the list.

2.15 The Council's reserves have increased significantly in recent years due primarily to underspends arising from higher fees and charges income and savings on major contracts, and a surplus on business rates. With Revenue Support Grant disappearing completely from 2020 the Council is in a transition stage to being self-financing. Suitable use of reserves is of fundamental importance in supporting this process and allowing the Council to invest in assets which will give long-term revenue streams which are far higher than the returns likely in the foreseeable future from bank and other deposits.

2.16 The deposits for the year are summarised below:

Investments	Balance on 31/3/16 £'000	Investments Made £'000	Maturities £'000	Balance on 31/03/17 £'000	Average Rate %	Average Life (days)
Short Term Investments	25,375	192,785	(191,640)	26,520	0.68	58
Long Term Investments	1,500	1,500	0	3,000	4.47	Undated
TOTAL INVESTMENTS	**26,875**	**194,285**	**(191,640)**	**29,520**		
Increase/ (Decrease) in Investments				2,645		

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

2.17 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.

2.18 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.

2.19 The Council's budgeted investment income for 2016/17 was £100,000 and the actual income received was £258,000. Of this additional return of £158,000 £53,424 is attributable to a higher level of balances and £104,576 is due to the investment in the CCLA Property Fund, the income return on which was 4.47% in the year. The Council's best performing investment in 2016/17 was its £3m of externally managed property fund. Because this investment has no defined maturity date, but is available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives is regularly reviewed. In light of its strong performance and the Council's latest cash flow forecasts, investment in this fund has been maintained for the 2017/18 financial year.

Compliance with Prudential Indicators

2.20 The Council has complied with its Prudential Indicators for 2016/17 which were set as part of the Treasury Management Strategy agreed by Council in February 2016.

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

Treasury Advisers

2.22 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.

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	The Council's Treasury Strategy is agreed annually as part of the budget process.
Legal and Statutory	Need to comply with CLG guidance on treasury management.
Crime and Disorder	Not relevant to this report
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

7. Appendices

7.1 Appendix I: Treasury Management and Prudential Indicators

8. Background Papers

None

Treasury Management and Prudential Indicators for 2016/17

1. Introduction

The Local Government Act 2003 requires the Authority 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 Authority 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 2016/17. Actual figures have been taken from or prepared on a basis consistent with, the Authority's statement of accounts

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

Capital Expenditure and Financing	2016/17 Estimate £'000	2016/17 Actual £'000	Difference £'000
Total Capital Expenditure	4,658	2,954	1,704
Capital Receipts	706	243	463
Government Grants	3,447	2,482	965
Reserves	505	229	276
Total Financing	4,658	2,954	1,704

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

Capital Financing Requirement	31/03/17 Estimate £'000	31/03/17 Actual £'000	Difference £'000
Total CFR	4,488	4,530	(42)
Less: Other Long Term Liabilities	(382)	(384)	2
Borrowing CFR	4,106	4,146	(40)
Less: External Borrowing	0	0	0
Cumulative Maximum External Borrowing Requirement	4,106	4,146	(40)

External borrowing: as at 31st March 2017 the Council did not have any external borrowing.

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. It links directly to the Authority'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 Authority's debt.

Operational Boundary and Total Debt	31/03/17 Boundary £'000	31/03/17 Actual Debt £'000	Complied
Borrowing	30,000	0	✓
Other long-term liabilities	382	384	x
Total Operational Boundary	30,382	384	✓

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 and Total Debt	31/03/17 Boundary £'000	31/03/17 Actual Debt £'000	Complied
Borrowing	35,000	0	✓
Other long-term liabilities	2,000	384	✓
Total Authorised Limit	37,000	384	✓

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2016/17.

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	31/03/17 Estimate %	31/03/17 Actual %	Difference %
General Fund Total	1.51	1.11	0.4

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.

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 proportion of net interest payable was:

Treasury Management and Prudential Indicators for 2016/17

Interest Rate Exposures	**31/03.17 Actual %**	**2016/17 Limit %**	**Complied**
Interest on fixed rate investments	-61	-100	✓
Interest on variable rate investments	-39	-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 Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31/03/17 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 Authority'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:

	2016/17 £'000
Actual principal invested beyond year end	3,000
Limit on principal invested beyond year end	10,000
Complied	✓

Investment Benchmarking

Average Actual Return on investments 2016/17	**Original Estimate Return on Investments 2016/17**	**Average Bank Rate 2016/17**	**Average 7 day LIBID Rate 2016/17**
0.68%	0.27%	0.34%	0.20%