Council		Agenda Item: 11
Meeting Date	24 January 2018	
Report Title	Treasury Management Half Year Report 2017/18	
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	Olga Cole, Management Accountant	
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 2017/18, including compliance with treasury limits and Prudential and Treasury Performance Indicators. The report was agreed by Audit Committee on 29 November 2017.

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.

2. Background

Market Environment

2.1 The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June, highlighting that some Monetary Policy Committee (MPC) members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their language, implying a rise in Bank Rate in "the coming months". At its meeting ending on 1 November 2017, the MPC voted by a majority of 7-2 to increase Bank Rate by 0.25 percentage points, to 0.5%.

2.2 CPI inflation rose to 3% in September. The MPC still expects inflation to peak above 3% in October, as the past depreciation of sterling and recent increases in energy prices continue to pass through to consumer prices. The effects of rising import prices on inflation are expected to diminish moving forward. Given the likely weakness of the economy, further rate rises could be very limited.

2.3 There were a few credit rating changes during the first six months of 2017/18. The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities.

2.4 Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following Arlingclose's advice, the Council reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

2.5 The new EU regulations for Money Market Funds were finally approved and published in July and existing funds will have to be compliant by no later than 21 January 2019. The key features include Low Volatility NAV (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends to convert to the LVNAV structure and awaits confirmation from each fund.

<u>Regulatory Updates</u>

MiFID II

2.6 Local authorities are currently treated by regulated financial services firms as professional clients who can "opt down" to be treated as retail clients instead. But from 3 January 2018, as a result of the Second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can "opt up" to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the Council must have an investment balance of at least £10 million and ensure that the person authorised to make investment decisions on behalf of the Council must have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

2.7 If the Council does not "opt up" to be a professional client it will mean that it will be restricted in its investments with limited access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Council meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status. However, it has to demonstrate this to each individual counterparty.

CIPFA Consultation on Prudential and Treasury Management Codes

2.8 In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes, and after reviewing responses, launched a further consultation on changes to the codes in August with a deadline for responses of 30 September 2017. The proposed changes include a new high-level Capital Strategy report to full Council which will cover the basics of the capital programme and treasury management, and the removal of certain prudential indicators, and the inclusion of commercial property investments and financial guarantees in the Treasury Management Strategy.

2.9 CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year.

DCLG Framework

2.10 The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England.

Borrowing

2.11 The Council continues to be debt free. Council has agreed to borrow up to £60m for capital purposes only - subject to individual business cases to Cabinet. The initial £30m intended to cover Sittingbourne Town Centre is the only borrowing planned – the additional £30m has not been earmarked for any projects. 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 look to internally borrow to minimise debt charge costs.

<u>Investments</u>

2.12 The counterparties agreed by Cabinet and Council earlier this year when the 2017/18 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 – to date only Nordea used) 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
Short Term 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
Covered Bonds	£9m in aggregate with £3m limit per bank
Absolute return funds	£3m in aggregate
Equity income funds	£3m in aggregate
Direct investments	Subject to business case to Cabinet

2.13 Investments held at 30 September 2017 can be found in Appendix I.

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

2.15 Interest income received for the first half of 2017/18 was £128,313.

2.16 For the six months to 30 September 2017, the Council maintained an average sum invested of £38m compared with an original budget of £35m, and an average rate of return of 0.68% compared to a budget of 0.30%.

2.17 The results for the six months to 30 September 2017 show that the Council achieved 0.57% average return above the average 7 day London Interbank Bid Rate (LIBID) and 0.43% average return rate above the average Bank of England Base Rate.

2.18 The Council has £3m invested in an externally managed property fund which is the CCLA fund which generated an average total return of 4.77%, comprising a £71,730 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

2.19 The Council can confirm that it has complied with its Prudential Indicators for 2017/18 which were set in February 2017 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.

2.20 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	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 2017
- Appendix II: Prudential and Treasury Management Indicators

8. Background Papers

None

Appendix I

Investments as at 30 September 2017

Counterparty	Long-Term Rating (S&P)	Balance Invested as at 30 September 2017 £'000
Lloyds Bank Plc	Aa3	3,000
Santander UK Plc	Aa3	3,000
Svenska Handelsbanken	Aa2	3,000
Close Brothers Ltd	Aa3	1,500
HSBC Bank	Aa3	3,000
Total Banks and Building Society		**13,500**
Goldman Sachs Money Market Fund	AAAm	2,740
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	3,000
Invesco Money Market Fund	AAAm	3,000
CCLA Property Fund		3,000
Total Money Market and Property Funds		**20,740**
Gross Total		**34,240**

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 2017/18

Investments	Balance on 01/04/2017 £'000	Investments Made £'000	Investments Repaid £'000	Balance on 30/09/2017 £'000	Average Rate %	Average Life
Short Term Investments	26,520	95,657	(90,937)	31,240	0.33	135 days
Long Term Investments	3,000	0	0	3,000	4.77	-
Total Investments	**29,520**	**95,657**	**(90,937)**	**34,240**	**0.68**	
Increase/(Decrease) in Investments				4,720		

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	**2016/17 Actual £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Gross CFR	4,530	4,294	4,074	3,929
Less: Other Long Term Liabilities	(384)	(181)	(24)	(3)
Borrowing CFR	**4,146**	**4,113**	**4,050**	**3,926**
Less: Existing Profile of Borrowing	0	0	0	0
Cumulative Maximum External Borrowing Requirement.	**4,146**	**4,113**	**4,050**	**3,926**

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	**2016/17 Actual £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Total Expenditure	**2,954**	**1,715**	**1,680**	**1,680**
Capital receipts	243	35	0	0
Grants	2,482	1,665	1,665	1,665
Revenue contributions	229	15	15	15
Total Financing	**2,954**	**1,715**	**1,680**	**1,680**

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 Actual %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
Total	1.11	(0.04)	(0.12)	(0.23)

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	2016/17 Actual £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Total Capital Financing Requirement	4,530	4,294	4,074	3,929

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 31/03/2017	£'000
Borrowing	0
Other Long-term Liabilities	384
Total	**384**

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.

Appendix II

Prudential and Treasury Management Indicators

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	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Borrowing	65,000	65,000	65,000
Other Long-term Liabilities	2,000	2,000	2,000
Total Debt	**67,000**	**67,000**	**67,000**

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	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Borrowing	60,000	60,000	60,000
Other Long-term Liabilities	181	24	3
Total Debt	**60,181**	**60,024**	**60,003**

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the period to 30 September 2017.

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.

Prudential and Treasury Management Indicators

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 30/09/17 %**	**2017/18 Approved Limit %**	**2018/19 Approved Limit %**	**2019/20 Approved Limit %**
Interest on fixed rate borrowing	0	100	100	100
Interest on fixed rate investments	-40	-100	-100	-100
Upper Limit for Fixed Interest Rate Exposure	**-40**	**0**	**0**	**0**
Interest on variable rate borrowing	0	100	100	100
Interest on variable rate investments	-60	-100	-100	-100
Upper Limit for Variable Interest Rate Exposure	**-60**	**0**	**0**	**0**

As the Council has no external 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 30/09/17 %**	**Lower Limit for 2017/18 %**	**Upper Limit for 2017/18 %**	**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 2017.

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.

Appendix II

Prudential and Treasury Management Indicators

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 Chief Financial Officer 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 Council having to seek early repayment of the sums invested.

Total Principal Sums Invested Over 364 Days	**2017/18 £'000**	**2018/19 £'000**	**2019/20 £'000**
Upper Limit Estimate	10,000	10,000	10,000
Actual	3,000	-	-
Complied	√	√	√

14. Investment Benchmarking for the six months to 30 September 2017

Average Actual Return on Investments	**Original Estimate Return on Investments**	**Average Bank Base Rate**	**Average 7 day LIBID Rate**
0.68%	0.30%	0.25%	0.11%