AUDIT GOVERNANCE & STANDARDS COMMITTEE	21st November 2016
Is the final decision on the recommendations in this report to be made at this meeting?	**Yes**

Treasury Management Half Yearly Review 2016/17

Final Decision-Maker	Audit Governance & Standards Committee
Lead Head of Service	Director of Finance & Business Improvement
Lead Officer and Report Author	John Owen, Finance Manager (Systems)
Classification	Public
Wards affected	All

This report makes the following recommendations to this Committee:

1. Notes the position of the Treasury Management Strategy as at 30th September 2016.
2. No amendments to the current procedures are necessary as a result of the review of activities in 2016/17.

This report relates to the following corporate priorities:

- Keeping Maidstone Borough an attractive place for all;
- Securing a successful economy for Maidstone Borough

An effective Treasury Management Strategy supports the achievement of all our corporate priorities.

Timetable	
Meeting	***Date***
Audit Governance & Standards Committee	21st November 2016

Treasury Management Half Yearly Review 2016/17

1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1 The Council has adopted CIPFA's Treasury Management Code of Practice which recommends that, as a minimum, a half and full yearly review on the Treasury Management function is reported to an appropriate Committee.

1.2 The Council has delegated this role to the Audit, Governance and Standards Committee.

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2. INTRODUCTION AND BACKGROUND

2.1 This report sets out the activities of the Treasury Management Function for the first 6 months of financial year 2016/17 in accordance with CIPFA's Code of Practice on Treasury Management in Local Authorities. It also sets this in the context of the economic environment over the past 6 months.

2.2 The key elements of the 2016/17 Strategy are:

2.2.1 Investment Strategy

- Maximum of £8m limit to be used for longer term investments (over 1 year) in highly secured instruments/institutions if it was deemed worthwhile to the Authority.
- Unsecured investments to be invested up to a maximum of 13 months dependent on credit worthiness and/or 'bail in' risks for the authority.

2.2.2 Borrowing Strategy

- An Authorised Limit for External Debt had been agreed by Members of up to £20.464m which is the indicator to show the maximum level of borrowing to fund the Council's Capital Programme, the Serco Paisa Loan and for day to day operations. Operational Debt had been set at £16.464m being the limit which external debt will not normally exceed.

2.3 An Economic Overview of 2016/17

2.3.1 The preliminary estimate of Q2 2016 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, as compared to 0.4% in Q1 and year/year growth running at a healthy pace of 2.2%. However the UK economic outlook changed significantly on 23rd June 2016. Forecasts had already been downgraded as 2016 progressed, as the very existence of the referendum dampened business investment, but the crystallisation of the risks and the subsequent political turmoil prompted further turbulence in household, business and investor sentiment.

2.3.2 The repercussions of this on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

2.3.3 In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. After six years of fiscal consolidation, the Autumn Statement on 23rd November is likely to witness fiscal initiatives to support economic activity and confidence, most likely infrastructure investment. Tax cuts or similar measures cannot be ruled out.

2.3.4 Whilst the economic growth consequences of Brexit remain speculative, there is a widespread view that uncertainty over the UK's future trade relations with the EU and the rest of the world will weigh on economic activity and business investment, dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. Although Q3 GDP figures were better than expected, these effects are likely to dampen economic growth for the rest of 2016 and in 2017.

2.3.5 Meanwhile, 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 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.

2.3.6 The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes, concentrating instead on the negative effects of Brexit on economic activity and, ultimately, inflation.

2.3.7 Market reaction: 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. The yield on the 10-year gilt fell from 1.37% on 23rd June to a low of 0.52% in August, a quarter of what it was at the start of 2016. The 10-year gilt yield has since risen to 0.69% at the end of September. The yield on 2- and 3-year gilts briefly dipped into negative territory intra-day on 10th August to -0.1% as prices were driven higher by the Bank of England's bond repurchase programme. However both yields have since recovered to 0.07% and 0.08% respectively. The fall in gilt yields was reflected in the fall in PWLB borrowing rates, as shown in the table below.

	Bank of England Base Rate	PWLB Borrowing Rates – Fixed Rate, Maturity Loans (Standard Rate)					
Date		**4½-5 yrs**	**9½-10 yrs**	**19½-20 yrs**	**29½-30 yrs**	**39½-40 yrs**	**49½-50 yrs**
	%	**%**	**%**	**%**	**%**	**%**	**%**
01/4/2016	0.50	1.50	1.86	2.54	2.99	3.25	3.34
30/4/2016	0.50	1.59	1.99	2.68	3.11	3.34	3.42
31/5/2016	0.50	1.58	1.97	2.58	2.99	3.23	3.30
30/6/2016	0.50	1.24	1.51	2.11	2.55	2.79	2.86
31/7/2016	0.50	1.13	1.34	1.87	2.31	2.58	2.67
31/8/2016	0.25	1.12	1.25	1.67	2.02	2.23	2.31
30/9/2016	0.25	1.05	1.22	1.72	2.13	2.36	2.44

2.4 Maidstone Borough Council Overview

2.4.1 The Council has used highly rated institutions to invest its funds and have kept all new investments during the first 6 months of 2016/17 short term (less than one year). £11.25m are held within the Council's Money Market Funds which are AAA rated funds and can be called upon instantly for meeting the Council's liabilities and to fund its capital programme. Total investments as at 30th September 2016 were £25.25m. A list of these can be found within **Appendix I**.

2.4.2 The average rate on Council investments is 0.77%. However, with rates falling lower, this average will reduce over the year. Investments are benchmarked against the 3 month LIBOR rate plus 20 basis points. 3 month LIBOR is 0.3828% as at 30th September 2016, plus the 20 basis points making the benchmark 0.5828%. The Council is currently operating at 32 basis points above this rate currently but this is unlikely to be sustainable.

2.4.3 Investment Income for the year to date as at 30th September 2016 totalled £106k.

2.4.4 At 31st March 2016 the Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was (£1.2m) negative, showing that the capital programme was affordable without recourse to borrowing. However, the Council had a forecasted CFR of £10m due to the expanded capital programme in 2016/17. As at 30th September 2016 there has been no need for the Council to borrow, due to slippage of capital expenditure into 2017/18. Furthermore, it does not appear that borrowing will be necessary to fund capital expenditure during the current year.

2.5 Annual Investment Strategy

2.5.1 The Treasury Management (TM) Strategy was approved for 2016/17 by Council in March 2016. The Council's Annual Investment Strategy is incorporated in the TM Strategy and outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

2.5.2 The Council will aim to achieve optimum return on investments after having satisfied proper levels of security and liquidity. It was agreed to keep investments short term with highly credit rated financial institutions, using the creditworthiness list, information provided by the Council's investment advisors, Arlingclose, along with sharing information with other local authorities and being mindful of market intelligence.

2.6 Prudential and Treasury Indicators

2.6.1 It is a statutory duty for the Council to determine and keep under review "Affordable Borrowing Limits". During the financial year 2016/17, the Council has operated with the prudential and treasury indicators set out in the Treasury Management Strategy Statement and in compliance with the Council's Treasury management Practices. The prudential and treasury indicators are shown within **Appendix II**.

2.7 Cash Management

2.7.1 The major element of the Council's Treasury Management function is the management on a daily basis of the cash requirements of the Council. The policy objectives are:

- The minimisation of the daily credit bank balance, subject to the clearance of monies overnight;
- Interest earned on investments should be maximised subject to the security of funds being paramount;
- Interest paid on borrowing should be minimised;
- Adequate funds should be available to meet precept, business rates and other payments as they fall due;
- Cash management activities are carried out in accordance with the agreed Treasury Management Strategy.

3. AVAILABLE OPTIONS

3.1 The Audit, Governance and Standards Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities within the first 6 months of 2016/17.

3.2 The Audit, Governance and Standards Committee proposes changes to the current procedures as a result of a review of activities within the first 6 months of 2016/17.

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 The Audit, Governance and Standards Committee agrees that no amendments to the current procedures are necessary as a result of a review of activities within the first 6 months of 2016/17 as there are no justifications to make any changes.

5. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

5.1 None

6. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

6.1 If The Audit, Governance and Standards Committee agree that no amendments to current procedures of the Treasury Management function are necessary, then there will be no further action.

7. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	This report monitors investment and borrowing activity set by Council for the financial year which is linked to the strategic plan and corporate priorities.	Director of Finance & Business Improvement
Risk Management	Risk management is included within the Treasury Management Practices to which the Council adheres. These risks comprise of: • credit and counterparty risk,	Director of Finance & Business Improvement

	• liquidity risk, • interest rate risk and • exchange rate risk, refinancing risk (however, the Council only deals in its home currency sterling). • Legal & regulatory risk • Fraud, error and corruption • Market risk management	
Financial	This report relates to the financial activities of the Council in respect of treasury management and specific financial implications are therefore detailed within the body of the report.	Director of Finance & Business Improvement
Staffing	None	
Legal	The report is in compliance with statutory and legal regulations, e.g. CIPFA Code of Practice on Treasury management in local authorities.	Interim Head of Mid Kent Legal Partnership
Equality Impact Needs Assessment	None	
Environmental/Sustainable Development	None	
Community Safety	None	
Human Rights Act	None	
Procurement	None	
Asset Management	None	

8. REPORT APPENDICES

The following documents are to be published with this report and form part of the report:

- Appendix I: Treasury Management Half Yearly Review – Investment Listing as at 30th September 2016
- Appendix II: Treasury Management Half Yearly Review – Prudential and Treasury Indicators

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9. BACKGROUND PAPERS

Arlingclose Template Report located within Corporate Finance.