AUDIT, GOVERNANCE & STANDARDS COMMITTEE	20 November 2017

Treasury Management Mid Year Review 2017/18

Final Decision-Maker	Audit, Governance & Standards Committee
Lead Head of Service/Lead Director	Ellie Dunnet - Head of Finance
Lead Officer and Report Author	John Owen – Finance Manager
Classification	Public
Wards affected	All

Executive Summary

This report sets out the activities of the Treasury Management Function for the first 6 months of financial year 2017/18 in accordance with CIPFA's Code of Practice on Treasury Management in Local Authorities.

This report makes the following recommendations to this Committee:

1. Notes the position of the Treasury Management Strategy as at 30 September 2017.
2. No amendments to the current procedures are necessary as a result of the review of activities in 2017/18.

Timetable	
Meeting	***Date***
Audit, Governance & Standards Committee	20 November 2017

Treasury Management Mid Year Review 2017/18

1. INTRODUCTION AND BACKGROUND

1.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

1.2 The Authority's Treasury Management Strategy for 2017/18 was approved by Council at a meeting on 1 March 2017. The Authority 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 are therefore central to the Authority's Treasury Management Strategy.

1.3 This report sets out the activities of the Treasury Management function for the first 6 months of financial year 2017/18 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.

1.4 The key elements of the 2017/18 Strategy are:

1.4.1 <u>Investment Strategy</u>

- The maximum principal sum to be invested for a period exceeding 364 days has been reduced to £5m from £8m. This is consistent with the borrowing strategy to utilise cash balances rather than loan debt to finance the capital programme in the short term, due to low investment returns and high counterparty risk in the current economic climate;

- The Council will endeavour to further diversify its portfolio, as far as is operationally feasible, ensuring that a combination of secured and unsecured investments are considered; and

- The expected level of interest income to be generated through investment returns has been revised downwards in light of the current economic outlook and interest rate forecasts.

1.4.2 <u>Borrowing Strategy</u>

- The maximum and expected prudential borrowing required to fund the capital programme was estimated at £1,029,870. However this did not include any internal borrowing, so the expected borrowing for the year in practice would have been nil.

1.5 <u>Economic Review of 2017/18</u>

1.5.1 UK Consumer Price Inflation (CPI) index rose with the data print for September showing CPI at 3.0%, its highest since June 2013, as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices.

1.5.2 The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively.

1.5.3 Gilt yields displayed significant volatility over the six-month period. The yield on the 5-year gilts fell to 0.35% in mid-June, but then rose to 0.80% by the end of September. The 10-year gilts similarly rose from their lows of 0.93% to 1.38% at the end of the quarter, and those on 20-year gilts from 1.62% to 1.94%.

1.5.4 UK bank credit default swaps continued their downward trend, reaching three-year lows by the end of June. There were a few credit rating changes during the quarter. 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. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1, placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide and Coventry building societies from negative to stable but downgraded the long-term rating of Leeds Building Society from A2 to A3. Standard & Poors also revised Nordea Bank's outlook to stable from negative, whilst affirming their long-term rating at AA-. The agency also upgraded the long-term rating of ING Bank from A to A+.

1.5.5 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 Authority 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.

1.5.6 The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. Bank Rate remained at 0.25% throughout this period (the Bank Rate has subsequently increased to 0.5% in November since writing this report).

1.6 Maidstone Borough Council Overview

1.6.1 The Council has used highly rated institutions which are listed on its counterparty list to invest its funds. All new investments during the first 6 months of 2017/18 are short term (less than one year) making them readily available when required. Total investments as at 30 September 2017 were £26.455m. A list of these can be found in **Appendix A**.

1.6.2 The average rate on Council investments is 0.42% and investment income totalled £106,000. Investment rates have remained low during this period and the Council's average investment rate has fallen below the benchmarked rate of 3 month LIBOR rate plus 10 basis points (0.43% as at 30 September 2017). Due to additional slippage in the capital programme, the Council has starting to invest slightly longer. This increases the risk of a counterparty failing so higher rated instruments will be utilised. However, this will mean that rates will not increase in line with the duration.

1.6.3 There has been no requirement to borrow during this period.

1.7 Annual Investment Strategy

1.7.1 The Treasury Management (TM) Strategy was approved for 2017/18 by Council in March 2017. 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

1.7.2 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.

1.8 Prudential and Treasury Indicators

1.8.1 It is a statutory duty for the Council to determine and keep under review 'Affordable Borrowing Limits.' During the financial year 2017/18, 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 B**.

1.9 Cash Management

1.9.1 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.

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2. AVAILABLE OPTIONS

2.1 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 2017/18.

2.2 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 2017/18.

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3. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

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 2017/18 as there are no justifications to make any changes.

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4. RISK

4.1 This report is presented for information only and has no risk management implications.

4.2 Risk management is included within the Treasury Management Practices to which the Council adheres. These risks comprise of:

- Credit and counterparty risk,
- 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.

5. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

5.1 None.

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6. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

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

7. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	We do not expect the recommendations will by themselves materially affect achievement of corporate priorities. However, they will support the Council's overall achievement of its aims as set out in section 3.	Head of Finance
Risk Management	Already covered in the risk section of the report.	Head of Finance
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.	Deputy Head of Mid Kent Legal Partnership
Privacy and Data Protection	None	
Equalities	None	
Crime and Disorder	None	
Procurement	None	

8. REPORT APPENDICES

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

- Appendix A: Treasury Management Mid-Year Review 2017/18 - List of Investments
- Appendix B: Treasury Management Mid-Year Review 2017/18 - Prudential and Treasury Indicators

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9. BACKGROUND PAPERS

9.1 None