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TONBRIDGE & MALLING BOROUGH COUNCIL

EXECUTIVE SERVICES

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7 July 2017

COUNCIL - TUESDAY, 11TH JULY, 2017

I am now able to enclose, for consideration at the Tuesday, 11th July, 2017 meeting of the Council, the following reports that were unavailable when the agenda was printed.

Agenda No Item

18. **Treasury Management Update and Annual Report for 2016/17 (Pages 3 - 26)**

    Item AU 17/31 referred from Audit Committee minutes of 3 July 2017 (Replacement for agenda item 12)

J E BEILBY
Chief Executive

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Item AU 17/31 referred from Audit Committee minutes of 3 July 2017

AU 17/31 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2016/17

The report of the Director of Finance and Transformation provided an update on treasury management activity undertaken during April and May of the current financial year within the context of the national economy. The treasury management outturn position for 2016/17, reported to the Cabinet on 28 June 2017, was also presented.

The Committee was advised that the outcome of the General Election had added to market uncertainty surrounding the Brexit negotiations. The interest rate forecast provided by Capita anticipated the Bank Rate remaining at 0.25% until June 2019.

It was noted that the summary of investment performance for 2016/17 indicated that the combined performance of the Council's cash flow and core funds had bettered the revised estimate by £25,500. Investment income earned in April and May of 2017/18 was also higher than expected, exceeding the estimate for the same period by £12,050.

The report provided a commentary on long term investment including progress in implementing the Council's decision regarding investment in property funds.

RECOMMENDED: That the following be commended to the Council:

(1) the action taken by officers in respect of treasury management activity for April and May 2017 be endorsed;

(2) the progress being made in respect of property fund investment be noted; and

(3) the 2016/17 outturn position be noted.
***Referred to Council**

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TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

03 July 2017

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Council

1 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2016/17

The report provides an update on treasury management activity undertaken during April and May of the current financial year. The treasury management outturn position for 2016/17 is also included in this report.

1.1 Introduction

1.1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) issued a revised Code of Practice for Treasury Management in November 2009. The revised Code was adopted by the Council on 18 February 2010 and suggests that Members should be informed of treasury management activity at least twice a year, but preferably quarterly. This report, therefore, ensures this Council is embracing best practice in accordance with CIPFA's revised Code of Practice and subsequent updates.

1.2 Economic Background

1.2.1 Despite the recent improvements in public finance data and healthier near term economic outlook the Chancellor’s spring budget introduced no major changes in government policy. The main focus areas for support were the NHS and social care, education and additional funds earmarked for businesses to assist with planned changes in business rates.

1.2.2 The budget was supported by updated economic growth and inflation forecasts by the Office for Budget Responsibility (OBR). The GDP forecast for 2016/17 was confirmed at 2.0%, increased to 1.8% for 2017/18 (1.3% last autumn) but reduced in subsequent years (now 1.6% in 2018/19 rising back to 2.0% in 2021/22). The Consumer Price Index forecast was confirmed at 1.0% for 2016/17, rising to 2.6% in 2017/18 and falling back to 2.0% in 2019/20. Since the spring budget, CPI has risen to its highest reading over the last four years to 2.9% for the 12 months ending May 2017.

1.2.3 In the February Inflation Report, the Bank of England moved to a ‘neutral’ policy position, stating that central bank policy can respond in ‘either direction’ to changes in the economic outlook, removing its previous view that a rate cut was likely. At the Bank's March meeting, the minutes noted 'it would take relatively little further upside news on the prospects for activity or inflation for them to consider that a more immediate reduction in policy support might be warranted'. The March meeting also saw one of its nine members vote for an immediate increase in Bank Rate. The June meeting saw three members vote for an increase.

1.2.4 In America the Federal Reserve raised the Fed Rate (equivalent of our Bank Rate) by 0.25% to 0.75% in December 2016. The rise, the second since 2006, was accompanied by an expectation that further rises would follow in 2017. The March meeting saw the Fed Rate increase by a further 0.25% to 1.00% and increase again by a further 0.25% at the June meeting.

1.2.5 The outcome of the General Election has added to market uncertainty surrounding the Brexit negotiations which commenced in June.

1.3 Interest Rate Forecast

1.3.1 The Bank Rate, having remained at an emergency level of 0.5% for over seven years, was reduced to 0.25% in August 2016. Capita, the Council's treasury advisor, provided an updated forecast in May 2017. The forecast anticipates the Bank Rate remaining at 0.25% until June 2019.

Rate	Now %	Sep-17 %	Dec-17 %	Mar-18 %	Jun-18 %	Sep-18 %	Dec-18 %	Mar-19 %	Jun-19 %	Sep-19 %	Dec-19 %	Mar-20 %
Bank Rate	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.50**	**0.50**	**0.75**	**0.75**
3 mth LIBID	**0.19**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.40**	**0.50**	**0.60**	**0.70**	**0.80**	**0.90**
6 mth LIBID	**0.33**	**0.40**	**0.40**	**0.40**	**0.40**	**0.40**	**0.50**	**0.60**	**0.70**	**0.80**	**0.90**	**1.00**
12 mthLIBID	**0.54**	**0.60**	**0.70**	**0.70**	**0.80**	**0.80**	**0.90**	**1.00**	**1.10**	**1.20**	**1.30**	**1.40**
25yr PWLB	**2.60**	**2.80**	**2.90**	**2.90**	**3.00**	**3.00**	**3.10**	**3.10**	**3.20**	**3.20**	**3.30**	**3.30**

1.4 Investment Performance

1.4.1 In accordance with the CIPFA Code the Council's priorities, in order of importance, are: to ensure security of capital; liquidity; and having satisfied both, to obtain an appropriate level of return which is consistent with the Council's risk appetite.

1.4.2 Funds available for investment comprise two distinct elements, cash flow surpluses and core cash.

1.4.3 Cash flow surpluses are available on a temporary basis and the amount mainly dependent on the timing of council tax and business rates collected and their payment to precept authorities and government. Less significant cash flows relate to receipt of grants, payments to housing benefit recipients, suppliers and staff. Cash flow surpluses build up during the course of a financial year and are spent by financial year end **[Annex 1]**. Thus far in 2017/18 cash flow surpluses have averaged £10.5m.

1.4.4 The Authority also has £22m of core cash balances. These funds are for the most part available to invest for more than one year, albeit a proportion is usually transferred to cash flow towards the end of the financial year to top-up daily cash balances. Core cash includes the Council's capital and revenue reserves which are being consumed over time to meet capital expenditure and 'buy time' to enable the authority to deliver its revenue savings targets. The core cash balance also includes some £8m to meet business rate appeals which are expected to be resolved in 2017/18 and 2018/19.

1.4.5 A full list of investments held on 26 May 2017 is provided at **[Annex 2]** and a copy of our lending list of the same date is provided at **[Annex 3]**. The table below provides a summary of funds invested and interest earned at 31 May 2017.

	Funds invested on 31 May 2017 **£m**	**Average duration to maturity** **Days**	**Weighted average rate of return** **%**	**Interest earned to 31 May 2017** **£**	**Gross annualised return** **%**	**LIBID benchmark (average from 1 April 2017)** **%**
Cash flow	9.3	33	0.43	7,150	0.40	0.11 (7 Day)
Core funds	22.0	137	0.67	25,750	0.67	0.20 (3 Mth)
Total	31.3	106	0.60	32,900	0.59	0.17 (Ave)

1.4.6 Interest earned of £32,900 to the end of May is £12,050 better than the original estimate for the same period. The authority also outperformed the LIBID benchmark by 42 basis points. The additional income is in part due to the higher core fund balance attributed to business rate appeal provisions.

1.5 Benchmarking

1.5.1 The Council takes advantage of Capita's benchmarking service which enables performance to be gauged against Capita's other local authority clients. An extract from the latest benchmarking data is provided in the form of a scatter graph at **[Annex 4]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. As at 31 March 2017 our return at 0.64% (purple diamond) was above the local authority average of 0.55%. Based on the Council's exposure to credit / duration risk that return was in-line with Capita's predicted return (just below the upper boundary indicated by the green diagonal line). The Council's risk exposure, whilst above average, was not excessive relative to others.

1.6 Compliance with the Annual Investment Strategy

1.6.1 Throughout April and May 2017 all of the requirements contained in the 2017/18 Annual Investment Strategy intended to limit the Council's exposure to investment risks (minimum sovereign and counterparty credit rating; durational limits; exposure limits in respect of counterparties, groups of related counterparty and sovereigns; and specified and non-specified investment limits) have been complied with. No borrowing was undertaken during April or May 2017.

1.6.2 The Council has also operated within the treasury limits and prudential indicators set out in the Annual Investment Strategy. The Prudential and Treasury Indicators will be included for review as part of the treasury management report to the September 2017 meeting of Audit Committee.

1.7 Long Term Investment Update

1.7.1 The availability of cash balances over the longer term (10 years) and the suitability of different types of long term investment (equities, bonds and property) was explored in the report to Audit Committee, January 2017. Of the alternatives, investment in property funds was considered the most appropriate. The use of property funds for both existing cash balances and any new money derived from the sale of assets was subsequently approved by Council in February 2017.

1.7.2 There are numerous property funds to choose from. Many have: a track record that precedes the 2008 financial crisis; a diverse **commercial property** portfolio (mix of retail, office and industrial / warehouse premises); a portfolio in excess of £500m; a client base of over 50 investors and; where investment is not classified as capital expenditure. Capita were engaged to assist with the detailed analysis required to identify the most appropriate funds to suit the Council’s needs. That assistance included analysis of: fund investment strategies; performance; portfolio composition; liquidity risk and fund management fees.

1.7.3 The analysis produced a shortlist of four funds who were invited to attend an interview at the Council’s offices in late May. The interviews with fund managers provided the opportunity to probe in more detail their differing investment strategies and portfolio mix. The process culminated in three funds being selected for immediate investment.

1.7.4 £2m of the Council’s existing cash balance has been identified for long term investment and is to be applied to investment in property funds. A further £1m anticipated from the disposal of existing property assets is also being applied now, bringing the total available for investment to £3m. Applications have been submitted and accepted by each of the: Local Authorities Property Fund; Hermes Property Unit Trust and the Lothbury Property Fund. Investment is to be diversified across the three funds to ensure, as far as is possible, stability of annual income and capital growth overtime. £1m is to be applied to each fund with investment expected to commence at the end of June 2017.

1.8 2016/17 Treasury Management Outturn

1.8.1 A detailed report covering treasury management activity for the last financial year was submitted to Cabinet on 28 June 2017 as an annex to the Revenue and Capital Outturn report for 2016/17. That annex is replicated in full and provided at **[Annex 5]** to this report. The role of this Committee is to act as scrutineer on behalf of full Council.

1.8.2 A summary of the investment performance included in Annex 5 is as follows:

2016/17 Financial Year	Average investment £m	Gross rate of return %	Interest earned £	Original / revised estimate £
Cash flow	16.0	0.57	91,500	82,000
Core funds	19.8	0.71	140,000	124,000
Total	35.8	0.65	231,500	206,000

1.8.3 The combined performance of the Authority's cash flow and core funds bettered the original / revised estimate by £25,500.

1.9 Legal Implications

1.9.1 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority including securing effective arrangements for treasury management. In addition, Capita are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.10 Financial and Value for Money Considerations

1.10.1 Investment income at the end of May 2017 (month two of the financial year) is £12,050 better than budget for the same period. Income for the 2016/17 financial year as a whole exceed budget by some £25,500.

1.10.2 The Bank Rate having remained at a historic low of 0.5% for over seven years was cut to 0.25% in August 2016. Capita, our treasury advisors, anticipate the Bank Rate will remain at this level until June 2019.

1.10.3 Performance is monitored against a benchmark return and against other local authorities in Kent and the broader local authority pool via Capita's benchmarking service.

1.10.4 Whilst the annual income stream from a property fund exhibits stability (circa 4.5% per annum net of management fees) capital values rise and fall with the cyclical nature of economic activity. During a downturn in the economy capital values may fall significantly. As a consequence the duration of a property based investment cannot be determined with certainty.

1.10.5 Buying and selling property involves significant costs making property unsuitable for short term investment. Buying and selling costs are reflected in the entry fees (circa 6%) and exit fees (circa 2%) a property fund will charge unit holders. These fees are expected to be recouped overtime through capital appreciation.

1.10.6 The money being applied to property fund investment from existing resources is expected to be available in perpetuity. Nevertheless, the Council's cash balances will continue to be monitored and due regard had to the potential for a fund to delay payment of redemption requests by up to 12 months. Funds will seek to minimise their own cash balances in favour of holding property and therefore manage redemption requests for the benefit of all fund participants. The Council is only likely to seek redemption to pursue a higher yielding income opportunity should one be identified.

1.11 Risk Assessment

1.11.1 The application of best practice, including the regular reporting and scrutiny of treasury management activity, as identified by the CIPFA Code is considered to be an effective way of mitigating the risks associated with treasury management.

1.12 Equality Impact Assessment

1.12.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act.

1.13 Recommendations

1.13.1 Members are invited to **RECOMMEND** that Council:

1) Endorse the action taken by officers in respect of treasury management activity for April and May 2017.

2) Note the progress being made in respect of property fund investment.

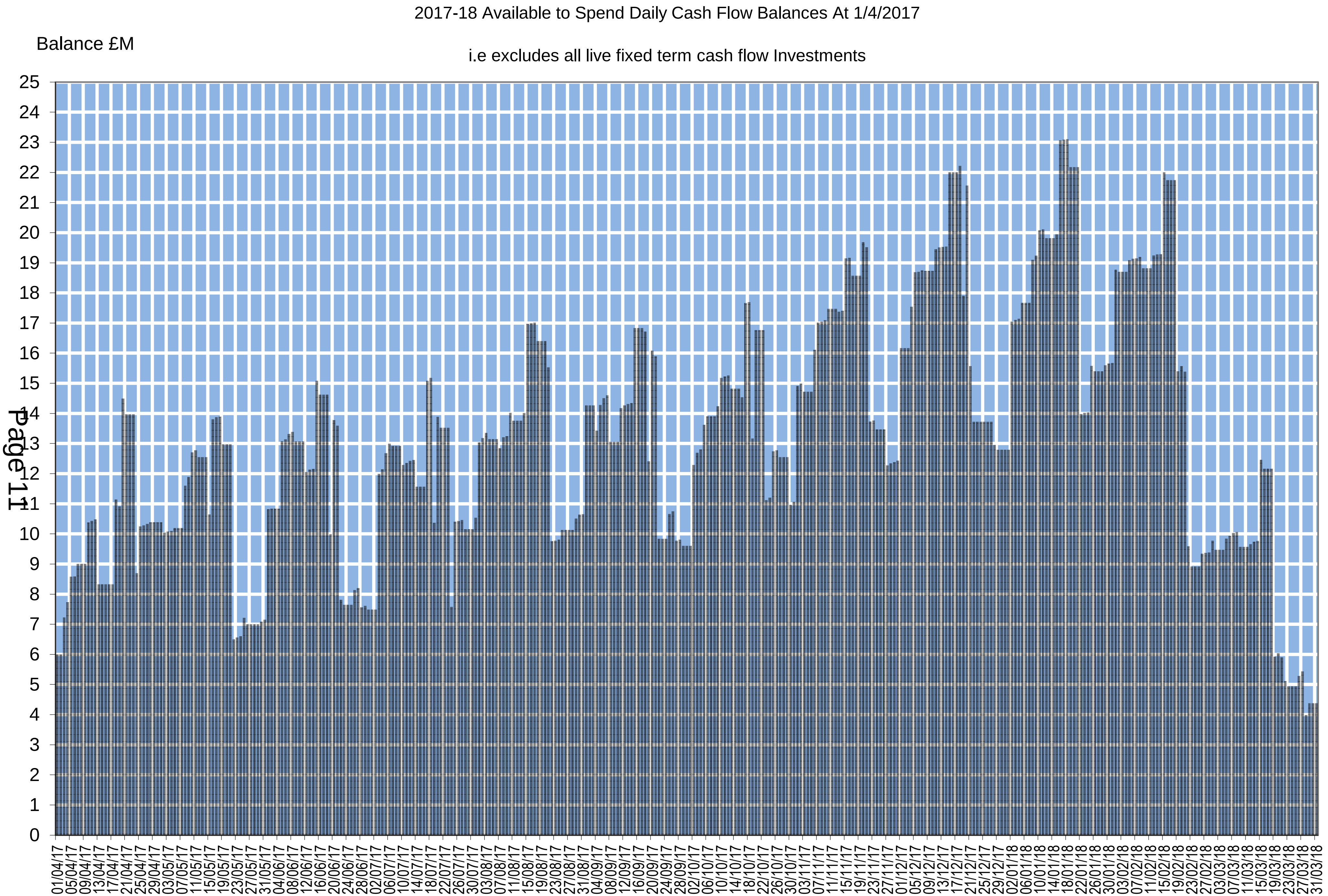
3) Note the 2016/17 outturn position.

Background papers: contact: Mike Withey

Capita interest rate forecast (May 2017)
Capita benchmarking data (March 2017)

Sharon Shelton
Director of Finance and Transformation

Annex 1



2017-18 Available to Spend Daily Cash Flow Balances At 1/4/2017
Balance £M
i.e excludes all live fixed term cash flow Investments

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Annex 2

Investment Summary as at 26 May 2017

Counterparty	Sovereign	Fitch Credit rating: Long Term	Fitch Credit rating: Short Term	Capita Suggested Post CDS Duration Limit	Investment: Start Date	Investment: End Date	Investment: Duration	Investment: Amount Invested £	Investment: Return %	Investment: Proportion of total %	Instrument type	Core Fund £	Cash Flow £
Bank of Scotland	UK	A+	F1	6 months	21/10/2016	21/07/2017	9 months	2,000,000	0.80%		Fixed Term	2,000,000	
Bank of Scotland	UK	A+	F1	6 months	23/03/2017	23/03/2018	12 months	500,000	0.80%		Fixed Term	500,000	
Bank of Scotland Total								**2,500,000**		8.15%			
Barclays Bank	UK	A	F1	6 months	26/09/2016	26/06/2017	9 months	1,000,000	0.58%		Fixed Term	1,000,000	
Barclays Bank	UK	A	F1	6 months	30/03/2017	21/03/2018	12 months	1,000,000	0.86%		CD		1,000,000
Barclays Bank	UK	A	F1	6 months	11/05/2017	27/04/2018	12 months	1,000,000	0.81%		CD	1,000,000	
Barclays Bank	UK	A	F1	6 months	12/05/2017	12/02/2018	9 months	2,000,000	0.51%		Fixed Term	2,000,000	
Barclays Bank Total								**5,000,000**		16.29%			
BNP Paribas MMF	n/a	AAA	mmf (Eq)	5 years	26/05/2017	30/05/2017	n/a	3,949,000	0.28%		Call - MMF		3,949,000
BNP Paribas MMF Total								**3,949,000**		12.87%			
Deutsche MMF	n/a	AAA	mmf	5 years	26/05/2017	30/05/2017	n/a	731,000	0.25%		Call - MMF		731,000
Deutsche MMF Total								**731,000**		2.38%			
Goldman Sachs Int'l Bank	UK	A	F1	6 months	09/09/2016	09/06/2017	9 months	3,000,000	0.68%		Fixed Term	3,000,000	
Goldman Sachs Int'l Bank	UK	A	F1	6 months	20/12/2016	20/09/2017	9 months	1,000,000	0.76%		Fixed Term	1,000,000	
Goldman Sachs Int'l Bank Total								**4,000,000**		13.03%			
Lloyds Bank	UK	A+	F1	6 months	14/10/2016	14/07/2017	9 months	1,000,000	0.80%		Fixed Term	1,000,000	
Lloyds Bank	UK	A+	F1	6 months	25/01/2017	21/10/2017	9 months	1,000,000	0.70%		Fixed Term	1,000,000	
Lloyds Bank	UK	A+	F1	6 months	23/03/2017	23/03/2018	12 months	500,000	0.80%		Fixed Term	500,000	
Lloyds Bank Total								**2,500,000**		8.15%			
NatWest Deposit Account	UK	BBB+	F2	1 year	26/05/2017	30/05/2017	n/a	10,000	0.01%		Call		10,000
National Westminster Bank Total								**10,000**		0.03%			
Royal Bank of Scotland	UK	BBB+	F2	1 year	28/03/2017	27/03/2018	12 months	2,000,000	0.73%		CD	2,000,000	
Royal Bank of Scotland Total								**2,000,000**		6.52%			
Santander Deposit Account	UK	A	F1	6 months	26/05/2017	30/05/2017	n/a	6,000,000	0.55%		Call	3,000,000	3,000,000
Santander UK Plc Total								**6,000,000**		19.55%			
Standard Chartered Bank	UK	A+	F1	6 months	16/02/2017	16/11/2017	9 months	2,000,000	0.76%		Fixed Term	2,000,000	
Standard Chartered Bank	UK	A+	F1	6 months	27/04/2017	26/01/2018	9 months	2,000,000	0.54%		Fixed Term	2,000,000	
Standard Chartered Bank Total								**4,000,000**		13.03%			
					Total invested			**30,690,000**		**100.00%**		**22,000,000**	**8,690,000**

Number of investments	19	**Average investment value £**			1,615,000
Number of counter parties	10	**Average counter party investment £**			3,069,000
Group exposures:		**Core £**	**Cash £**	**Combined £**	**%**
RBS + National Westminster (UK Nationalised 25%)		2,000,000	10,000	2,010,000	6.55
Bank of Scotland + Lloyds (20%)		5,000,000	-	5,000,000	16.29

Total non-specified investments should be less than 60% of Core Funds	0.00%

CD = Certificate of Deposit

n/c = no colour / no new investment

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Tonbridge and Malling Borough Council Lending List

Checked against Capita Duration Matrix dated 26/05/17

Minimum investment criteria is Capita Green (100 days) Duration Band
(entry point broadly equates to Fitch A-, F1 unless UK nationalised / semi-nationalised).

Counterparty	Sovereign	Sovereign Rating [1]	Fitch Long Term	Fitch Short Term	Exposure Limits			Capita Duration [2]	
					Cash Flow	Core Fund	Combined	Credit Rating	Post CDS
Bank of Montreal	Canada	AAA	AA-	F1+	£3m	£3m	£6m	12 months	12 months
Toronto Dominion Bank	Canada	AAA	AA-	F1+	£3m	£3m	£6m	12 months	12 months
Deutsche Bank	Germany	AAA	A-	F1	£3m	£3m	£6m	100 days	100 days
Rabobank (Cooperatieve Rabobank U.A.)	Netherlands	AAA	AA-	F1+	£3m	£3m	£6m	12 months	12 months
ING Bank	Netherlands	AAA	A+	F1	£3m	£3m	£6m	6 months	6 months
Nordea Bank AB	Sweden	AAA	AA-	F1+	£3m	£3m	£6m	12 months	12 months
Svenska Handelsbanken AB	Sweden	AAA	AA	F1+	£3m	£3m	£6m	12 months	12 months
Bank of Scotland (Group limit with BOS and Lloyds of £6m)	UK	AA	A+	F1	£2m	£4m	£6m	6 months	6 months
Barclays Bank	UK	AA	A	F1	£2m	£4m	£6m	6 months	6 months
Goldman Sachs Int'l Bank	UK	AA	A	F1	£2m	£4m	£6m	6 months	6 months
HSBC Bank	UK	AA	AA-	F1+	£3m	£3m	£6m	12 months	12 months
Lloyds Bank (Group limit with BOS and Lloyds of £6m)	UK	AA	A+	F1	£2m	£4m	£6m	6 months	6 months
Santander UK	UK	AA	A	F1	£3m	£3m	£6m	6 months	6 months
Standard Chartered Bank	UK	AA	A+	F1	£2m	£4m	£6m	6 months	6 months
Coventry Building Society	UK	AA	A	F1	£3m	£3m	£6m	6 months	6 months
Nationwide Building Society	UK	AA	A+	F1	£3m	£3m	£6m	6 months	6 months
National Westminster Bank [3] (Group limit with Nat West and RBS of £7.6m)	UK	AA	BBB+	F2	£3.8m	£3.8m	£7.6m	12 Months	12 Months
The Royal Bank of Scotland [3] (Group limit with Nat West and RBS of £7.6m)	UK	AA	BBB+	F2	£3.8m	£3.8m	£7.6m	12 Months	12 Months
UK Debt Management Office including Treasury Bills	UK	AA	N/A	N/A	No limit	No limit	No limit	N/A	N/A
UK Treasury (Sovereign Bonds-Gilts)	UK	AA	N/A	N/A	No limit	£7.5 / 15m	£7.5 / 15m	N/A	N/A
UK Local Authorities	UK	AA	N/A	N/A	£3m	£3m	£6m	N/A	N/A

[1] Reflects the lowest of the three rating agencies views (Fitch, Moody's and Standard and Poor's). Strategy requires sovereigns to be rated at least AA-. Non-UK 20% sovereign limit equals combined limit quoted above (£6m).
[2] **All deposits overnight** unless otherwise **approved in advance** by the Director of Finance and Transformation **AND** Chief Financial Services Officer. If other than overnight, duration for non-UK entities must not exceed Capita's post CDS duration assessment. For UK entities, duration may be extended by up to three months **based on credit ratings alone** or six months if **CDS is below average** subject to a maximum combined duration of 12 months.
[3] UK nationalised / semi-nationalised.

Money Market Funds
Minimum investment criteria one of AAA-mf, AAAmmf or AAAm

Fund Name	Moody	Fitch	S&P	Exposure Limit		
				Cash Flow	Core Fund	Combined
Blackrock	AAA-mf	-	AAAm	£6m	-	£6m
BNP Paribas	-	-	AAAm	£6m	-	£6m
Goldman Sachs	AAA-mf	AAAmmf	AAAm	£6m	-	£6m
Deutsche Fund	AAA-mf	AAAmmf	AAAm	£6m	-	£6m
Standard Life (Ignis)	-	AAAmmf	AAAm	£6m	-	£6m
Morgan Stanley	AAA-mf	AAAmmf	AAAm	£6m	-	£6m
Prime Rate	-	AAAmmf	AAAm	£6m	-	£6m
Insight Liquidity Group limit for IL and ILP of £6m	-	AAAmmf	AAAm	£6m	-	£6m

Enhanced Cash Funds
Minimum investment criteria AAA

Fund Name	Moody	Fitch	S&P	Exposure Limit		
				Cash Flow	Core Fund	Combined
Insight Liquidity Plus Group limit for IL and ILP of £6m	-	-	AAAf /S1	£1.5m	£1.5m	£3m

Approved by Director of Finance & Transformation
26th May 2017

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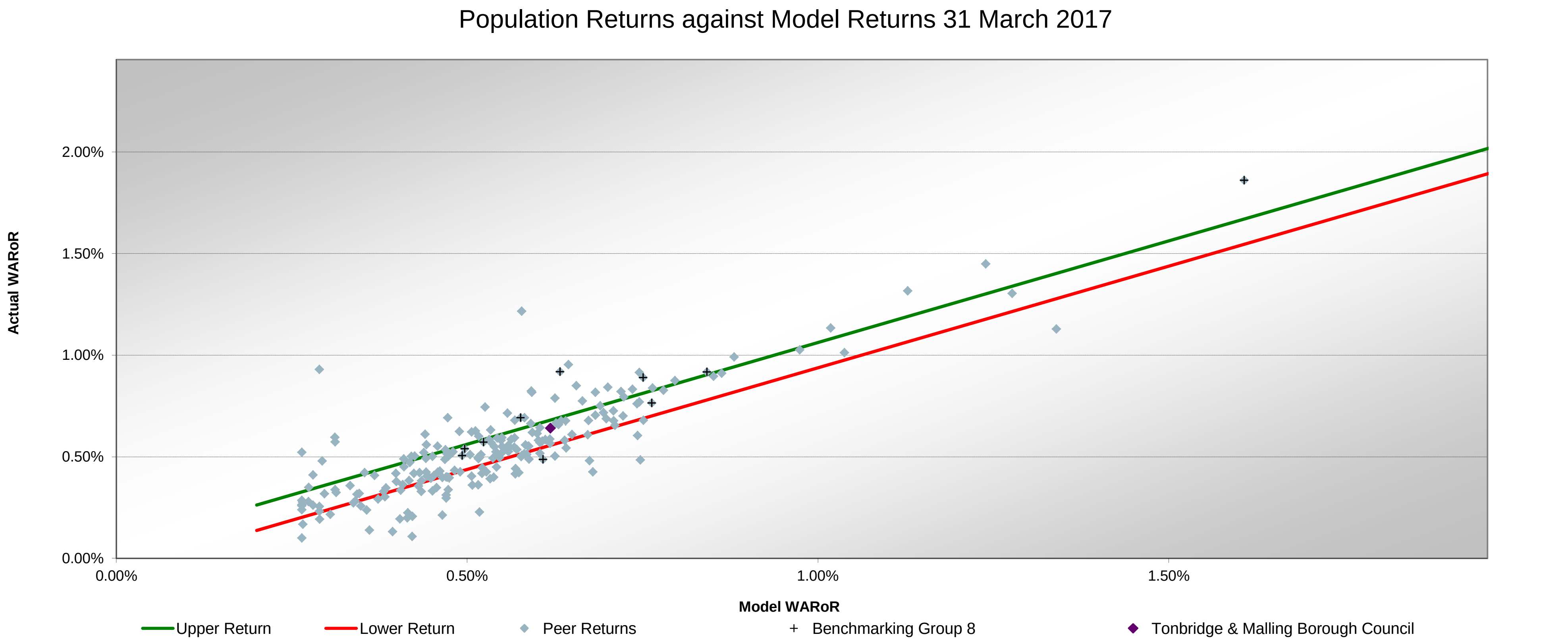
Tonbridge & Malling Borough Council



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Tonbridge & Malling Borough Council	0.64%	0.62%	0.02%	0.56%	0.68%	Inline

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Treasury Management Annual Report 2016/17

1.1 Introduction

1.1.1 This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activity and the actual prudential and treasury indicators for 2016/17 **[Appendix 1]**. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.1.2 During 2016/17 the minimum reporting requirements were that full Council should receive the following reports:

- an annual treasury strategy in advance of the year;
- a mid-year treasury update; and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

In addition, treasury management updates have been presented to each meeting of the Audit Committee throughout the 2016/17 financial year. Treasury performance was also considered at the Finance, Innovation and Property Advisory Board through the regular Financial Planning and Control reports.

1.1.3 Changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

1.1.4 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to full Council.

1.2 The Economy and Interest Rates

1.2.1 The outcome of the June 2016 EU referendum and subsequent action by the Bank of England's Monetary Policy Committee (MPC) in August had a significant impact on interest rate expectations by the financial markets. Forecasts contained in the Bank of England's August inflation report anticipated economic growth in the UK was likely to fall close to zero in the second half of 2016. In response the MPC, at its meeting on 4 August, cut the Bank Rate from 0.5% to 0.25%, restarted the Bank's programme of quantitative easing (buying back Gilts) and introduced Term Funding (cheap financing made available to banks). The MPC also warned that a second cut in Bank Rate may be required later in 2016.

1.2.2 Actual economic activity in the second half of 2016 confounded the Bank's pessimistic August forecast. Whilst GDP grew by only +0.2% in Q1 2016, growth in the following three quarters returned to recent norms with +0.6%, +0.5% and +0.7% respectively. Growth for 2016 as a whole at 1.8%, whilst a little below the 2.2% produced in 2015, bettered that achieved by the majority of G7 countries.

1.2.3 Inflation, however, has risen rapidly following the devaluation of sterling after the referendum. By the end of March 2017, sterling was 17% down against the dollar. In February 2017, CPI inflation had risen above the MPC's 2% inflation target to 2.3%. Markets expect the MPC to set aside near term supply side driven inflation and not raise Bank Rate provided domestically generated inflation (i.e. wage inflation) continues to remain subdued. Current market expectation is for Bank Rate to rise mid-2019.

1.3 Treasury Position at 31 March 2017

1.3.1 At the beginning and the end of 2016/17 the Council's debt and investment position was as follows:

	31 March 2016 £m	Rate / Return %	Average duration Days	31 March 2017 £m	Rate / Return %	Average duration Days
Variable rate debt:						
Overdraft	0.00	-	-	0.00	-	-
Total debt	**0.00**	-	-	**0.00**	-	-
Fixed rate investments:						
Cash flow	2.00	0.85	204	-	-	-
Core funds	8.75	0.87	139	17.00	0.69	118
Variable rate investments:						
Cash flow	6.62	0.59	1	6.10	0.50	61
Core funds	6.85	0.73	89	7.00	0.65	114
Total investments	**24.22**	**0.75**	**92**	**30.10**	**0.64**	**105**

1.3.2 The rise in investment balances between the start and end of the financial year runs counter to the expectation that core cash will be consumed over time as a proportion is used each year to finance capital expenditure and to finance the revenue account deficit until such time as the authority achieves a balanced budget. The rise in investment balances is wholly attributed to provisions under the Business Rates Retention Scheme to meet the cost of appeals which have yet to be determined by the Valuation Office. As at 31st March 2017, the provision to meet business rate appeals was some £7m.

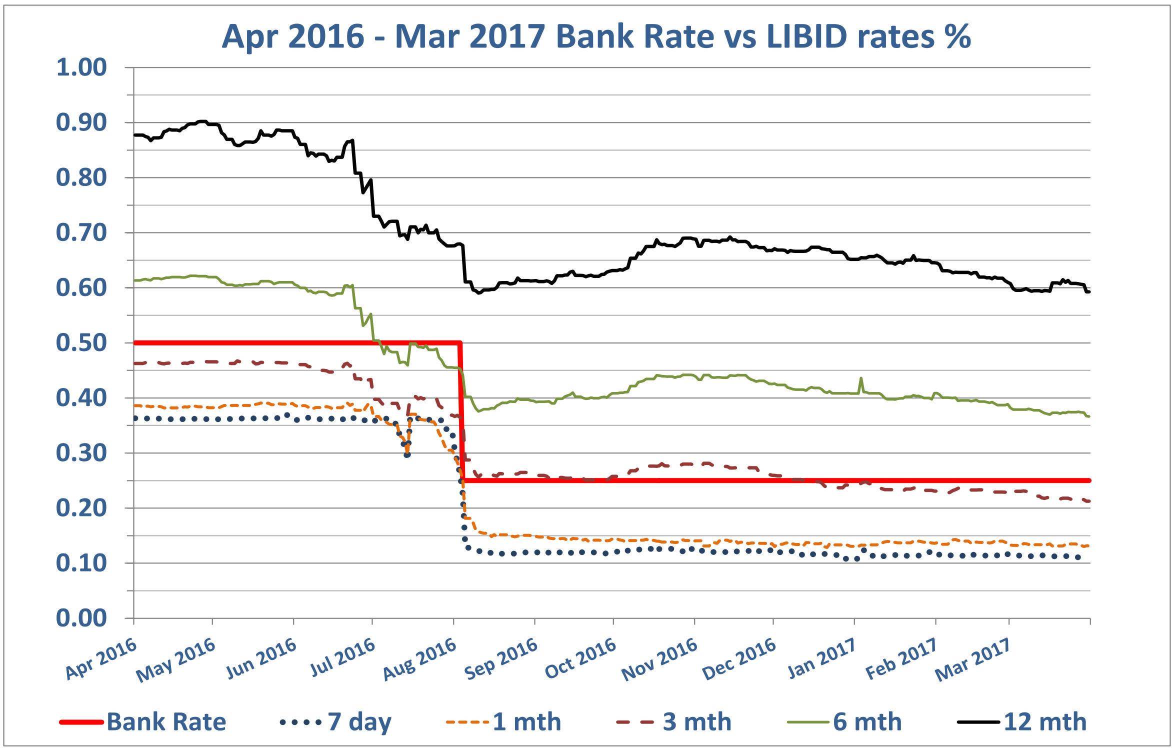
1.4 The Strategy for 2016/17

1.4.1 The expectation for interest rates within the treasury management strategy for 2016/17 anticipated a low but rising Bank Rate starting in quarter 2 of 2016. In addition, continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns. Events that have taken place since the Strategy was prepared

(December 2015) have pushed back the anticipated rise in Bank Rate to mid-2019.

1.5 Investment Rates in 2016/17

1.5.1 The Bank Rate having remained at a historic low of 0.5% for over seven years was cut to 0.25% in August 2016. The impact the EU referendum and subsequent Bank Rate cut had on investment returns in 2016/17 is demonstrated in the table below.



1.6 Investment Outturn for 2016/17

1.6.1 The Council's investment policy sets out the approach for choosing investment counter-parties and is based on credit ratings provided by the three main credit rating agencies. This is supplemented by additional market information including credit rating outlooks and credit default swap data (CDS). The 2016/17 Annual Investment Strategy was approved by Council in February 2016 and was subjected to a mid-year review in September 2016. In undertaking the review, no changes were made to the Council's minimum counter-party credit requirement (Fitch A-, F1 unless UK state owned) or counter-party exposure limits (20% for non-UK state owned financial institutions). Discretion to extend investment duration by up to three months over the Council's external treasury advisor's suggested duration was also retained albeit pending further review. At the January 2017 meeting of Audit Committee Members amended the discretion to six months subject to a number of constraints (only to applicable to UK institutions; overall duration not to exceed twelve months; and the institutions CDS to be below bank average at the time of placing the deposit).

1.6.2 The mid-year review was undertaken just after the MPC's August Bank Rate meeting. Provided there was no subsequent action by the MPC, the Council's investment income forecasts at the time anticipated income for the year as a whole would be in-line with budget. This reflected a combination of higher than expected balances available for investment and action taken in advance of the referendum to invest as much of the Council's cash surpluses in term deposits as was practical. Investment income for 2016/17 was confirmed at £206,000 (as originally estimated) when the revised estimates were subsequently approved by Council in February 2017.

1.6.3 **Cash Flow Investments**. The Council maintained an average balance of £16.0m in cash flow funds. These funds earned an average rate of return of 0.57%. The average 7-day LIBID rate, used to compare performance, was 0.20%. The majority of cash flow funds are required to meet our regular payment obligations and as a consequence are invested overnight in bank deposit accounts and money market funds which allow next day access. However, the opportunity to invest for longer durations and generate additional yield is taken when cash flow surpluses permit. Throughout 2016/17 cash balances were higher than budget reflecting a continuation of the beneficial change by Government to the pattern of business rates paid to them, KCC and Kent Fire and Rescue.

1.6.4 **Core Fund Investments**. The Council maintained an average balance of £19.8m in core funds. These funds earned an average rate of return of 0.71%. The 3-month LIBID rate used as a comparator was 0.34%. Unlike cash flow, core fund balances are not required to meet our regular payment obligations and are available to invest for longer durations including durations exceeding one year. This added flexibility allows core funds to generate a better return relative to cash flow investments.

1.6.5 Performance for the financial year as a whole is summarised in the table below:

	2016/17 Average Balance £m	Return %	2016/17 Interest Earned £	2016/17 Original / Revised Estimate £	Variance Better (worse) £
Cash flow	16.0	0.57	91,500	82,000	9,500
Core funds	19.8	0.71	140,000	124,000	16,000
Total	35.8	0.65	231,500	206,000	25,500

1.6.6 The combined performance of the Authority's cash flow and core funds bettered the original / revised estimates by £25,500.

1.7 Compliance with the Annual Investment Strategy

1.7.1 The Annual Investment Strategy aims to limit the Council's exposure to investment risks by prescribing: minimum counter-party credit criteria; maximum exposure limits in respect of sovereigns, counter-parties and group of related counter-party; the type of investment instrument that can be used; and investment duration limits. Throughout the period April 2016 to March 2017 the requirements set out in the Annual Investment Strategy for 2016/17, as amended by Council in February 2017, were complied with. No liquidity issues were experienced resulting in nil borrowing throughout 2016/17.

Financial Services
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Prudential and Treasury Indicators

1 **Prudential Indicators**	2015/16 Actual £'000	2016/17 Original £'000	2016/17 Actual £'000
Capital expenditure	3,287	3,314	1,632
Ratio of financing costs to net revenue stream	-1.90%	-2.07%	-2.33%
Net borrowing requirement:			
Brought forward 1 April	nil	nil	nil
Carried forward 31 March	nil	nil	nil
In year borrowing requirement	nil	nil	nil
Capital financing requirement as at 31 March	nil	Nil	nil
Annual change in capital financing requirement	nil	Nil	nil
Incremental impact of capital investment decisions:			
Increase in Council Tax (Band D) per annum	£0.24	£0.10	£0.10

2 **Treasury Management Indicators**	2015/16 Actual £'000	2016/17 Original £'000	2016/17 Actual £'000
Authorised limit for external debt:			
Borrowing	nil	5,000	nil
Other long term liabilities	nil	nil	nil
Total	nil	5,000	nil
Operational boundary for external debt:			
Borrowing	nil	2,000	nil
Other long term liabilities	nil	nil	nil
Total	nil	2,000	nil
Actual external debt	nil	Nil	nil
Upper limit for fixed rate exposure over one year at year end	nil	0 – 60%	nil
Upper limit for variable rate exposure under one year at the year end	13,468 (55.6%)	40 – 100%	13,098 (43.5%)
Upper limit for total principal sums invested for over 364 days	nil (0%)	60%	nil (0%)

3 **Maturity structure of new fixed rate borrowing during 2016/17**	Upper limit %	Lower limit %
Under 12 months	100	nil
Over 12 months	nil	nil

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