TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

11 February 2016

Report of the Director of Finance &Transformation

Part 1- Public

Matters for Recommendation to Council

1 TREASURY MANAGEMENT AND ANNUAL INVESTMENT STRATEGY 2016/17

1.1 The report provides details of investments undertaken and returns achieved in the first nine months of the current financial year. The report also provides an introduction to the Treasury Management and Annual Investment Strategy for 2016/17. Members are invited to recommend adoption of the Strategy to full Council.

1.2 Introduction

1.2.1 The Local Government Act 2003 requires the Council to 'have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable'.

1.2.2 The Act also requires the Council to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy. The latter sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.2.3 The Strategies are set out in a single document at **[Annex 4]** to this report.

1.2.4 The portfolio of the Audit Committee includes the review of treasury management activities. Accordingly, that Committee was asked to review the matters covered by this report and **[Annex 4]** on 25 January 2016. Due to timing issues it will be necessary to verbally report upon any recommendations and observations made by the Audit Committee.

1.2.5 The Strategy is a complex technical document and is a specialist area of work**, I should be grateful if Members could raise any queries with the author of this report (Michael Withey ext. 6103) in advance of the meeting** as Michael will not be present on 2 February.

1.3 Treasury Management Update

1.3.1 In accordance with the CIPFA Treasury Management Code of Practice, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. Yields remain low in-line with the 0.5% Bank Rate. As a consequence, investment returns are expected to remain low relative to pre 2008 financial crisis levels throughout the remainder of this financial year and the next pending a rise in Bank Rate.

1.3.2 Cash flow funds are available on a temporary basis and their amount varies from month to month and during the course of each month dependent on the timing of receipts (collection of business rates, council tax, grants and other sources of income) and payments (to government, precepting authorities, housing benefit recipients, staff and suppliers). The authority holds £15.5m of core cash balances for investment purposes. These funds which comprise our revenue and capital reserves are for the most part available to invest for more than one year.

1.3.3 At the end of December 2015 funds invested and interest earned is set out in the table below:

	Funds invested at 31 Dec 2015 **£m**	**Average duration to maturity** **Days**	**Weighted average rate of return** **%**	**Interest earned to 31 Dec 2015** **£**	**Gross annualised return** **%**	**LIBID benchmark** **%**
Cash flow	18.5	36	0.70	78,800	0.66	0.36 (7 Day)
Core funds	15.5	101	0.84	83,950	0.82	0.46 (3 Month)
Total	34.0	66	0.76	162,750	0.73	0.41 (Average)

1.3.4 Interest earned of £162,750 is £19,600 better than the revised budget for the same period and £36,550 better when compared to the original estimate for 2015/16. The authority also outperformed the LIBID benchmark by 32 basis points. The pattern of income generation is expected to be maintained to year end such that income for the financial year as a whole is likely to be in the region of £210,000, some £42,500 better than originally anticipated.

1.3.5 **Cash flow funds**. Our daily cash flow balances for the year ahead are modelled at the start of the financial year. That cash flow model is then updated daily and reviewed on a regular basis. Cash flow surpluses will typically be invested overnight in bank deposit accounts and money market funds to ensure sufficient short term liquidity to meet payment obligations. However, when cash surpluses permit, fixed term investments are undertaken to take advantage of the higher yields available. In April £5m nine month fixed term investments were undertaken yielding circa 0.8%. Mid-summer £6.5m six month fixed term investments were placed yielding an average of 0.7%. More recently £2.5m three month deposits, yielding 0.55%, have been placed to take advantage of this year's cash flow balances which peak in December.

1.3.6 A significant element of the Council's daily cash balance relates to the collection of business rates, the majority of which is paid over to Government, KCC and Kent Fire and Rescue. Whilst the Council is responsible for determining when to collect, Government determines when payments to themselves and others are due. In 2014/15 and earlier years payments to Government and others were spread over ten monthly instalments starting in April and ending the following January. For 2015/16 outgoing payments have been spread over 12 equal monthly instalments starting in April. The result has been higher daily balances, which have been available for longer, enabling the council to undertake more fixed term investments than would otherwise have been the case. More, higher yielding, term deposits are the main reason for the additional income referred to above. The current payment profile to Government is being reviewed by them and there is no guarantee that it will be retained for 2016/17. An announcement is expected early in 2016.

1.3.7 **Core funds**. Following the transfer of all core fund investments from our extremal fund manager to in-house management in August 2014, the opportunity to enhance yield by extending duration has continued. The current core fund portfolio includes a mix of nine and twelve month deposits together with one high yielding call account. The pattern of maturities, predominantly monthly from December to April, is designed to ensure additional liquidity is available to the Council to support spending towards the end of the financial year and to take advantage of improved offers from banks as we approach a rise in Bank Rate. Thus far this financial year the level of income generated from core funds, whilst a little higher, is still broadly in-line with original expectations.

1.3.8 **Current investment position**. A full list of investments held on 31 December 2015 is provided at **[Annex 1]** and a copy of our lending list of the same date is provided at **[Annex 2]**.

1.3.9 **Capita benchmarking data**. The Council takes advantage of Capita's benchmarking facility which enables us to gauge our performance 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 3]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. As at 30 September 2015 our return at 0.79% (purple diamond) was above the average of 0.68% for all other local authorities and relative to the Council's exposure to credit / duration risk that return exceeded Capita's predicted return (just above the upper boundary indicated by the green diagonal line).

1.4 Treasury Management and Annual Investment Strategy 2016/17

1.4.1 The strategy includes the parameters that aim to limit the Council's exposure to investment risks by requiring investments to be placed with highly credit rated institutions and that those investments are diversified across a range of counterparties. In common with the 2015/16 Annual Investment Strategy, the Strategy proposed for 2016/17 and detailed at **[Annex 4]** requires:

- Counterparties must be regulated by a Sovereign rated AA- or better as recognised by each of the three main rating agencies (Fitch, Moody's or Standard & Poor's).

- Whilst 100% of funds can be invested in the UK, exposure to non-UK banks is restricted to no more than 20% of funds per Sovereign.

- Exposure to individual counterparties / groups of related counterparty must not exceed 20% of funds (25% of funds for part state owned UK Banks).

- In selecting suitable counterparties the Council has adopted Capita's credit worthiness methodology. The methodology combines the output from all three credit rating agencies including credit watches / outlooks and credit default swap data to assign a durational band to a financial institution (100 days, 6 months, 12 months, 5 years, etc.). At the time of placing an investment the financial institution must be assigned a durational band of at least 100 days. This broadly equates to a minimum long term credit rating of Fitch A- (high) and a short term credit rating of Fitch F1 (strong).

- The duration of an investment in a foreign bank must not exceed Capita's recommendation. For UK financial institutions Capita's duration recommendation can be enhanced by up to three months subject to the combined duration (Capita recommendation plus the enhancement) not exceeding 12 months.

- Money Market funds should be rated Fitch AAAmmf or equivalent and exposure limited to no more that 20% per fund.

- Enhanced Money Funds should be rated AAA and exposure limited to no more than 10% per fund and 20% to all such funds.

1.4.2 The strategy also limits the type of instrument (e.g. term deposits, floating rate notes, etc.) that can be used and establishes a maximum investment duration (2 years other than Gilts). Given our overriding investment priorities of security of capital and liquidity the Council does not invest in equities.

1.4.3 At the present time the Council has access, both directly and via brokers, to an adequate number of high credit rated financial institutions allowing an appropriate level of diversification. Our cash flow forecasting aims to ensure the Council has sufficient liquidity to meet payment obligations. Excess liquidity is avoided by using term deposits to generate additional yield when daily cash balances permit. Whilst the 2016/17 Strategy has been updated to reflect the current economic environment and latest interest rate forecast, the risk parameters set out in the 2015/16 approved strategy have been retained.

1.5 Legal Implications

1.5.1 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.

1.5.2 This report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2009.

1.6 Financial and Value for Money Considerations

1.6.1 The Bank Rate has remained at a historic low of 0.5% for over 7 years. Capita, our treasury advisors, in common with other market forecasts, anticipate an interest rate rise mid-2016.

1.6.2 At the end of December investment income is £19,600 better than the revised budget for the same period, £36,550 better when compared to the original estimate. Income for the 2015/16 financial year as a whole is likely to be in the region of £210,000, some £42,500 better than originally expected.

1.6.3 The higher level of income is largely attributed to a more favourable pattern of payments to Government and other recipients of business rates collected by the Council. The payment profile applying to the 2016/17 financial year may be less favourable and has yet to be announced by Government.

1.6.4 In anticipation of a Bank Rate rise part way through 2016 a modest uplift over current returns is built into the investment income projection for 2016/17. Cash flow returns in 2016/17 are expected to be 0.75% against a return of 0.66% at the end of December. Core funds are expected to generate a return of 1.0% in 2016/17 against a return of 0.82% at the end of December. The 2016/17 estimates include total investment income of £206,000.

1.6.5 Investment performance is monitored against relevant benchmarks and compared to other local authorities using benchmarking data provided by Capita.

1.7 Risk Assessment

1.7.1 Capita are employed to advise on the content of the Treasury Management and Annual Investment Strategy and this, coupled with a regular audit of treasury activities ensures that the requirements of the Strategy and the Treasury Policy Statement adopted by this Council are complied with.

1.7.2 Credit ratings remain a key tool in assessing risk. It is recognised that their use should be supplemented with sovereign ratings and market intelligence. Appropriate sovereign, group and counterparty limits need to be established to ensure an appropriate level of diversification.

1.7.3 In the light of these safeguards and stringent Treasury Management Procedures it is considered that any risks to the authority implicit in the 2016/17 Strategy have been minimised.

1.8 Equality Impact Assessment

1.8.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

1.9 Recommendations

1.9.1 Members are invited to **RECOMMEND** that full Council:

1) note the treasury management position as at 31 December 2015;

2) adopts the Treasury Management and Annual Investment Strategy for 2016/17 set out at **[Annex 4]**.

Background papers: contact: Mike Withey

Nil

Sharon Shelton
Director of Finance & Transformation