TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

05 April 2016

Report of the Director of Finance and Transformation

Part 1- Public

Delegated

1 TREASURY MANAGEMENT UPDATE

This report provides an update on treasury management activity undertaken during the 2015/16 financial year within the context of the national economy and invites Members to endorse the action taken by officers and note the treasury position at the end of February 2016.

1.1 Introduction

1.1.1 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 ensures the Council is embracing Best Practice in accordance with CIPFA's revised Code of Practice and subsequent updates.

1.2 Economic Background

1.2.1 The start of 2016 saw significant falls in stock markets around the world following renewed concerns of a downturn in the Chinese economy and the implications for global growth and commodity prices. Whilst stock markets have largely recovered in recent weeks the prospect of weaker global growth going forward remains an issue.

1.2.2 In America the Federal Reserve raised the Fed Rate (equivalent of our Bank Rate) by 0.25% to 0.50% in December 2015. The rise, the first since 2006, was accompanied by an expectation that four, albeit limited, rises would follow in 2016. At the conclusion of the March FOMC meeting, chair Janet Yellen, citing economic risks from abroad scaled back that prediction to two rate rises.

1.2.3 As part of his March budget, the Chancellor presented the latest forecasts from the Office for Budgetary Responsibility (OBR) for both economic growth and public sector borrowing. The OBR has suggested that productivity growth is set to remain weak and that this will have a meaningful effect on economic growth going forward. Consequently, GDP growth forecasts were revised down and are now predicting GDP to be between 2.0% and 2.2% over the course of the next 5 years (vs 2.2% and 2.5% Autumn Statement 2015). Faced with an economy growing slower than anticipated, the Chancellor introduced additional cuts in government spending to allow a budget surplus to be returned in 2019/20.

1.2.4 At the March meeting of the Bank of England's Monetary Policy Committee (MPC), members voted unanimously to hold the Bank Rate at 0.5% and make no change to the programme of quantitative easing. Faced with low inflation, a slowing economy, worrisome foreign markets and the uncertainty of the referendum on the UK's membership of the European Union, there is little to no pressure on the MPC to tighten monetary policy in the near term.

1.2.5 The Consumer Price Index (CPI) rose by 0.3% in the twelve months to January and was around 0% throughout 2015. The BoE anticipate inflation will rise above the 2% target over the course of the next two to three years. Given the anticipated trajectory of inflation, the current market expectation of a rate rise in the UK being delayed to 2019, looks pessimistic. Whilst recent commentary from the MPC suggests they are likely to refrain from a rate rise in 2016, a rise sometime in 2017 would fit with inflation forecasts.

1.3 Interest Rate Forecast

1.3.1 The Bank Rate has remained at an emergency level of 0.5% for the last 7 years. Capita's latest forecast, updated in February 2016, anticipates the Bank Rate will remain at this level for a further 9 months before rising in the first quarter of 2017.

Rate	Now %	Mar-16 %	Jun-16 %	Sep-16 %	Dec-16 %	Mar-17 %	Jun-17 %	Sep-17 %	Dec-17 %	Mar-18 %	Jun-18 %	Sep-18 %
Bank Rate	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**
3 mth LIBID	**0.52**	**0.50**	**0.50**	**0.60**	**0.60**	**0.80**	**0.90**	**1.00**	**1.10**	**1.30**	**1.30**	**1.60**
6 mth LIBID	**0.66**	**0.70**	**0.70**	**0.70**	**0.80**	**0.90**	**1.00**	**1.20**	**1.40**	**1.60**	**1.70**	**1.80**
12 mthLIBID	**0.98**	**1.00**	**1.00**	**1.00**	**1.10**	**1.20**	**1.30**	**1.50**	**1.70**	**1.90**	**2.00**	**2.10**
25yr PWLB	**3.05**	**3.20**	**3.20**	**3.30**	**3.30**	**3.50**	**3.50**	**3.60**	**3.60**	**3.70**	**3.70**	**3.70**

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 Cash flow funds are available on a temporary basis and their amount varies from month to month and during the course of each month depending on the timing of receipts (council tax, business rates, grants and other sources of income) and payments (precepts, NNDR pool contributions, benefits, staff and suppliers). In addition the Council has £14.8m of core cash balances available for investment.

These funds which comprise our revenue and capital reserves are for the most part available to invest for more than one year.

1.4.3 As at the end of February 2016, funds invested and interest earned is set out in the table below.

	Funds invested on 29 Feb 2016 £m	Average duration to maturity Days	Weighted average rate of return %	Interest earned to 29 Feb 2016 £	Gross annualised return %	LIBID benchmark %
Cash flow	16.9	33	0.62	102,350	0.65	0.36 (7 day)
Core funds	14.8	103	0.85	105,450	0.82	0.46 (3 month)
Total	31.7	66	0.73	207,800	0.73	0.40 (average)

1.4.4 Interest earned of £207,800 is £33,450 better than the revised budget for the same period and £54,050 better when compared to the original estimate for 2015/16. The authority also outperformed the LIBID benchmark by 33 basis points. Income for the financial year as a whole is likely to be in the region of £221,000, some £53,500 better than originally anticipated.

1.4.5 A full list of investments held on 26 February 2016 and our lending list of the same date are provided at **[Annex 1]** and **[Annex 2]**.

1.4.6 The Council participates in Capita's benchmarking service which enables the Council to gauge 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) against credit / duration risk (horizontal scale) associated with an authority's investments. At the end of December 2015 our return (purple diamond) was in-line with that anticipated by the model based on our exposure to credit / duration risk. At 0.76% the Council's return bettered the non-metropolitan district average of 0.69% and the overall population average (includes county councils, unitary, police and fire authorities) of 0.70%.

1.4.7 **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 2015, £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%. In December 2015, £2.5m three month deposits, yielding 0.55%, were placed to take advantage of the mid-February peak in cash flow balances.

1.4.8 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 accounts for some £38,500 (72%) of the additional income referred to above. The current payment profile to Government is going to be retained by them for 2016/17 which should largely offset any delay in interest rate rises.

1.4.9 **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 comprises mainly nine month term deposits and includes one high yielding call account. The pattern of maturities in spring 2016 and again in autumn 2016 ensures additional liquidity is available to the Council to support spending at the end of the financial year and to take advantage of improved offers from banks as we approach a rise in Bank Rate. Income generated from core funds for the 2015/16 financial year as a whole is expected to be some £15,000 higher than originally anticipated.

1.5 Borrowing

1.5.1 It is a statutory duty for the Council to determine and keep under review the 'Affordable Borrowing Limits' by way of the Prudential Indicators (affordability limits) set out in the approved Treasury Management Strategy Statement. In this regard it is confirmed that no borrowing was undertaken in the period April 2015 to February 2016.

1.6 Compliance with the Annual Investment Strategy

1.6.1 Throughout the period April 2015 to February 2016 the requirements set out in the 2015/16 Annual Investment Strategy which aim to limit the Council's exposure to investment risks (minimum counterparty credit criteria; sovereign, counter-party and group exposure limits; type of investment instrument; and investment duration limits) have been complied with.

1.7 Legal Implications

1.7.1 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.

1.8 Financial and Value for Money Considerations

1.8.1 The Bank Rate has remained at a historical low (0.5%) for a seventh successive year. The 'Funding for Lending' initiative introduced by the Bank of England in summer 2012 had a significant downward impact on returns being offered by financial institutions at the time and that impact has continued. At the end of February 2016, investment income of £207,800 has been earned exceeding our revised estimate for the same period by £33,450. Income for the financial year as a whole is likely to be in the region of £221,000, some £53,500 better than originally anticipated (£38,500 cash flow and 15,000 core funds).

1.8.2 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.

1.9 Risk Assessment

1.9.1 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.

1.10 Equality Impact Assessment

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

1.11 Recommendations

1.11.1 Members are invited to **recommend** that Cabinet:

1) endorse the action taken by officers in respect of treasury management activity for the period April 2015 to February 2016; and

2) note the treasury position at the end of February 2016.

Background papers: contact: Mike Withey

Forecast and benchmarking data provided by Capita.

Sharon Shelton
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