TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

29 June 2016

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Council

1 TREASURY MANAGEMENT UPDATE AND ANNUAL REPORT FOR 2015/16

A report detailing treasury management activity undertaken in April and May of the current financial year is to be considered by Audit Committee on 20 June. That report also includes details of the treasury management outturn for the 2015/16 financial year. Following a commentary on the application of credit default swap data (market view of risk) Member approval is sought to enhance the existing flexibility afforded to officers when determining the appropriate duration for term deposits.

1.1 Introduction

1.1.1 Council adopted the 2009 CIPFA Code of Practice for Treasury Management on 18 February 2010. That Code, and subsequent updates, requires as a minimum that full Council receives an annual strategy published prior to the start of the financial year, a mid-year review of that strategy and an outturn report (this report).

1.1.2 Additional reports updating Members on current activity are presented to Audit Committee and performance is also reported on a regular basis to the Finance, Innovation and Property Advisory Board. The combination of Member reporting and detailed scrutiny of activity ensures this Council complies with best practice.

1.2 2016/17 Treasury Management Performance

1.2.1 As at the end of May 2016 funds invested and interest earned is set out in the table below.

	Funds invested at 31 May 2016 £m	Average duration to maturity Days	Weighted average rate of return %	Interest earned to 31 May 2016 £	Gross annualised return to 31 May 2016	LIBID benchmark %
Cash flow	9.7	103	0.74	14,100	0.67	0.36 (7 Day)
Core fund	15.6	133	0.81	20,900	0.80	0.46 (3 Mth)
Total	25.3	121	0.78	35,000	0.75	0.41 (Ave)

1.2.2 Interest earned of £35,000 is £5,400 better than the original estimate for the same period and 34 basis points better than benchmark.

1.3 2015/16 Treasury Management Outturn

1.3.1 The outturn report to Audit Committee is included in **[Annex 3]** of the Revenue and Capital Outturn report elsewhere on this agenda. Prudential and treasury indicators for 2015/16 are included at **[Annex 3 - Appendix 1]**.

1.3.2 Investment income of £226,100 earned during the year bettered the revised estimate by £36,100. The gross return for the year of 0.73% exceeds the LIBID benchmark by 33 basis points.

1.4 Term Deposit Duration

1.4.1 A key part of the treasury advisory service provided to the Council by Capita is a weekly update on the creditworthiness of a financial institution. The assessment uses the credit ratings provided by each of the three main rating agencies to score an institution. The score determines which durational band a bank / building society is assigned to. Banks deemed suitable for local authority investment will be assigned a durational band of 100 days, 6, 9, 12 or 24 months. The assessment also incorporates a market view of risk using credit default swap data. A credit default swap (CDS) can be likened to insurance taken out by investors to guard against the risk of default. Depending on a bank's CDS price relative to the average CDS for all banks, Capita will confirm the duration band based on credit ratings alone; reduce duration by one band (e.g. 6 months based on credit ratings is reduced to 3 months after taking CDS into account); or advise that no new investment is placed with the institution (the durational band becomes nil months).

1.4.2 CDS prices rose significantly following the collapse of Lehman Brothers in 2008 and reached a peak at the height of the Eurozone sovereign debt crisis in December 2011 prompting the Bank of England Financial Policy Committee to warn UK banks to prepare to withstand an 'extraordinarily serious and threatening' economic environment. Since then, the European Central Bank has introduced measures to ease bank liquidity, established a mechanism to contain sovereign bond yields and progressed a European Banking Union. The aggregate value of CDS trades has been on a downward trajectory since December 2011 and is now broadly in-line with levels pre the financial crisis.

1.4.3 In November 2015, Capita recognised the more benign state of the CDS market and modified their use of the data. Whilst the rational for change appeared well founded, in practice the new approach has proven to be less precise in signalling market concern for a particular institution and has the potential to trigger false warnings when average CDS prices rise dramatically.

1.4.4 Following the announcement of a referendum on the UK's membership of the European Union, a premium was applied to all UK bank CDS prices. During late March and most of April that premium resulted in Capita's duration assessment for UK banks being scaled back (typically, a six month assessment based on credit ratings was reduced to three months after applying CDS data). The time frame coincided with and delayed the reinvestment of a significant proportion of the Council's core funds and the investment of cash flow surpluses as they began to build in April. Volatility in the CDS market has since subsided and whilst those investments have now all been placed the delay was both unsatisfactory and unnecessary. However, should a similar situation arise in the future its impact can be negated.

1.4.5 When undertaking term deposits the Annual Investment Strategy affords officers the discretion to add up to three months to Capita's post CDS duration assessment. Where officers consider it appropriate, the recommendation at paragraph 1.9.1, allows that same discretion to be applied to Capita's duration assessment based on credit ratings alone. Members are reminded that term deposits are only made with the agreement of the Chief Financial Services Officer and Director of Finance and Transformation and that agreement is sought via a written proposal from the Treasury Manager. Each investment proposal, taking into account the likely timing of interest rate changes, addresses the security and liquidity implications of a particular investment. In future, any use of the discretion to set aside CDS data and the justification for doing so will be drawn out in the investment proposal. Members are also reminded that the discretion to extend duration by up to three months only applies to UK entities and that the combined duration (Capita duration plus three month discretion) must not exceed twelve months.

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 At year end investment income for 2015/16 of £226,100 exceeded the 2015/16 revised estimate by £36,100. Investment income earned to the end of May 2016 of £35,000 is £5,400 above budget expectations for 2016/17.

1.6.2 All investments undertaken in 2015/16 and thus far in 2016/17 have complied with the requirements of the relevant Treasury Management Strategy Statement and Annual Investment Strategy.

1.7 Risk Assessment

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

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 Subject to any comments from the Audit Committee, Cabinet is invited to **RECOMMEND** that Council:

1) Endorse the action taken by officers in respect of treasury management activity for April and May 2016,

2) Note the 2015/16 outturn position, and

3) Enhance the flexibility afforded to officers when determining the appropriate duration for term deposits as outlined in paragraph 1.4.5.

Background papers: contact: Mike Withey

Nil

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