TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

03 April 2017

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 2016/17 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 2017.

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 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.

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.

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%.

1.2.5 Eurozone growth remained steady in quarter four of 2016 at 0.4% (1.7% year-on-year).

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's current forecast (November 2016) anticipates the Bank Rate remaining at 0.25% until June 2019.

Rate	Now %	Mar-17 %	Jun-17 %	Sep-17 %	Dec-17 %	Mar-18 %	Jun-18 %	Sep-18 %	Dec-18 %	Mar-19 %	Jun-19 %	Sep-19 %
Bank Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50
3 mth LIBID	0.23	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.40	0.50	0.60	0.70
6 mth LIBID	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.70	0.80
12 mthLIBID	0.62	0.70	0.70	0.70	0.70	0.70	0.80	0.80	0.90	1.00	1.10	1.20
25yr PWLB	2.90	2.90	2.90	2.90	3.00	3.00	3.00	3.10	3.10	3.20	3.20	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. Thus far in 2016/17 cash flow surpluses have averaged £16.4m.

1.4.4 The Authority also has £24m 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 has risen since the start of the financial year and includes funds 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 28 February 2017 is provided at **[Annex 1]** and a copy of our lending list of the same date is provided at **[Annex 2]**. The table below provides a summary of funds invested and interest earned at that date.

	Funds invested on 28 Feb 2017 £m	**Average duration to maturity Days**	**Weighted average rate of return %**	**Interest earned to 28 Feb 2017 £**	**Gross annualised return %**	**LIBID benchmark %**
Cash flow	13.2	1	0.43	88,850	0.59	0.22 (7 day)
Core funds	24.0	96	0.64	128,300	0.71	0.33 (3 mth)
Total	37.2	62	0.57	217,150	0.66	0.28 (average)

1.4.6 Interest earned of £217,150 is £28,500 better than the original estimate for the same period. The authority also outperformed the LIBID benchmark by 38 basis points. The additional income is attributed to higher than expected cash flow and core cash balances at the start of the financial year and the opportunity that this created to invest more funds in higher yielding term deposits.

1.4.7 Every opportunity to invest in term deposits in advance of the June referendum was taken (£18m in term deposits at the end of June 2016 compared to £16m June 2015). This action together with a more flexible use of cash flow and core cash balances (surplus cash flow has been transferred to core cash and cash flow balances replenished with core fund maturities) has helped negated the impact of the August Bank Rate cut (from 0.5% down to 0.25%). Investment income for the year as a whole is now expected to exceed budget by some £25,000.

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 3]**. The graph shows the return (vertical scale) vs. the credit / duration risk (horizontal scale) associated with an authority's investments. At 31 December 2016, our return at 0.61% (purple diamond) was above the local authorities' average of 0.55% and relative to the Council's exposure to credit /

duration risk that return was at the upper end of Capita's predicted return (just below the upper boundary indicated by the green diagonal line). The Council's risk exposure was slightly above the local authorities' average. As Members will recall from previous treasury reports the result is typical of the enhanced performance achieved following the transfer of all core cash investments to in-house management in August 2014.

1.6 Long term Investment Update

1.6.1 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.

1.6.2 There are numerous property funds available 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 have been engaged to assist with the detailed analysis required to identify the most appropriate funds to suit the Council's needs. That assistance includes analysis of: fund investment strategies; performance; portfolio composition; liquidity risk and fund management fees. Capita's analysis and short list of suitable funds is expected to be available at the end of April. Interviews with fund managers will be held during May with a view to commencing investment at the end of June.

1.6.3 Of the Council's existing cash balances, £2m is available for long term investment and is expected to be applied to a property fund investment. Other resources (new money) made available from the sale of existing assets may also be invested in property funds as the disposals take place.

1.7 Borrowing

1.7.1 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 2016 to February 2017.

1.8 Compliance with the Annual Investment Strategy

1.8.1 Throughout the period April 2016 to February 2017 the requirements set out in the 2016/17 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.

1.9 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 February 2017 (month eleven) is £28,500 better than budget for the same period. Income for the 2016/17 financial year as a whole is expected to exceed budget by some £25,000.

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 The delay by the valuation office in determining business rate appeals has resulted in the Council's cash balances being higher than expected throughout 2016/17. The action outlined at paragraph 1.4.7 combined with higher cash balances has negated the impact the August Bank Rate cut would otherwise have had on investment income in 2016/17. However, relative to previous expectations, the lower bank rate will result in reduced investment income over the medium term. The enhanced income from a property fund investment will mitigate some of that impact.

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 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.

1.11 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 Cabinet:

1) endorse the action taken by officers in respect of treasury management activity for the period April 2016 to February 2017; and

2) note the treasury position at the end of February 2017.

Background papers: contact: Mike Withey

Forecast and benchmarking data provided by Capita.

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