TREASURY MANAGEMENT ACTIVITY REPORT 2016/17 (1st April 2016 – 31st August) **21st September 2016** **AUDIT COMMITTEE**	**Classification:** **Public**
Ward(s) affected **None**	
Group Director **Ian Williams, Group Director Finance & Corporate Resources**	

1. Introduction

This report provides Members of the Audit Committee with a quarterly update on Treasury Management.

2. Recommendation(s)

The Audit Sub-Committee is recommended to:

- **Note the report**

3. Background

This report is the first of the treasury reports relating to the financial year 2016/17 for the Audit Committee. It sets out the background for treasury management activity from April 2016 to August 2016 and the action taken during this period.

4.1 Policy Context

Ensuring that the Treasury Management function is governed effectively means that it is essential for those charged with governance to review the operations of treasury management on a regular basis. This report forms part of the regular reporting cycle for Audit Committee, which includes reviewing the Annual Treasury Management Strategy, and enables the Committee to monitor treasury activity throughout the financial year.

4.2 Equality Impact Assessment

There are no equality impact issues arising from this report

4.3 Sustainability

There are no sustainability issues arising from this report

4.4 Consultations

No consultations have taken place in respect of this report.

4.5 Risk Assessment

There are no risks arising from this report as it sets out past events. Clearly though, the treasury management function is a significant area of potential risk for the Council, if the function is not properly carried out and monitored by those charged with responsibility for oversight of treasury management. Regular reporting on treasury management ensures that the Committee is kept informed.

5. Comments of the Group Director, Finance and Corporate Resources

There are no direct financial consequences arising from this report as it reflects the performance from April to August 2016. Whilst investment interest is not used to underpin the Council's base revenue budget, as in some other authorities, there will be an impact on the ability to fund additional discretionary expenditure and capital programmes. The information contained in this report will assist Members of this Committee in monitoring the treasury management activities and enable better understanding of such operations.

6. Comments of the Director Legal Services

The Accounts and Audit Regulations 2015 place obligations on the Council to ensure that its financial management is adequate and effective and that it has a sound system of internal control which includes arrangements for management of risk. In addition the Council within its Annual Treasury Management Strategy has agreed to comply with the CIPFA Code of Practice on Treasury Management. This report demonstrates that Treasury Management is meeting these requirements and adapting to changes as they arise.

7. Economic Highlights

- **Growth:** The second estimate of Q2 GDP released in September by the Office of National statistics showed the UK economy growing by 0.6% over the quarter and 2.2% year-on-year, this was in line with market expectation. The largest contribution to growth came from the service area.

- **Inflation:** The Consumer Prices Index (CPI) rose by 0.6% in the year to July 2016. This was above market expectations of 0.5%. The main contributors to the increase in the rate were rising prices for motor fuels, alcoholic beverages and accommodation services.

- **Monetary Policy:** At its meeting in August, the Monetary Policy Committee voted unanimously to cut base rate to 0.25% from 0.5% and to introduce Term Funding Scheme. The committee also voted to increase the stock of purchases of gilts to £435 billion from £375 billion, and voted 8 – 1 to purchase £10 billion of corporate bonds. The action by the MPC follows the vote by the UK to leave the European Union. On the back of the leave vote the exchange rate has fallen and outlook for economic growth in the short to medium term weakened.

  The Committee undertook a cut in Bank Rate to lower borrowing costs for companies and households. However, as interest rates were close to zero it was likely to be difficult for some banks and building societies to reduce deposit rates much further, which in turn might limit their ability to cut their lending rates. To avoid the risk that reductions in Bank Rate did not feed through fully to the rates faced by households and businesses, the MPC considered the establishment of a Term Funding Scheme that would provide funding for banks at interest rates close to Bank Rate. This would provide participants with a cost effective source of funding in the form of central bank reserves to support additional lending to the real economy.

8. Borrowing & Debt Activity

8.1 The Authority currently has £3.6m in external borrowing. This is made up as a single LEEF loan from the European Investment Bank to fund housing regeneration.

8.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council has an increasing CFR due to its capital program and therefore has forecast a future borrowing requirement. Borrowing to fund capital expenditure can be external, such as from the Public Works and Loan Board (PWLB), or internal, by borrowing from cash balances and reserves.

8.3 The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internally borrowing. This is where internal funds (cash and reserve balances) are used to finance capital expenditure instead of borrowing the funds from an external source.

8.4 Assuming the Council continue to earn an average of 0.89% (Table 2) on its investments, it is currently significantly more cost-effective to borrow internally, rather than take on external debt from the PWLB or other sources. While we would lose investment income of around 0.79% we would avoid paying the interest on external debt at around 2 - 3%. The potential difference in cost is highlighted in table 1.

Table 1: External v Internal borrowing

	External Borrowing	Internally Borrowing
Borrowing amount	£100 m	£100 m
Borrowing rate	1.54%*	0.89%**
Annual cost	**£1.54 m**	**£0.89 m**

* PWLB 10 year certainty rate
** Council's current weighted average return

8.5 External borrowing rates currently far exceed the return the Council is making on its investments, so savings can be achieved by borrowing internally from reserves

8.6 Table 1 highlights the annual cost of internally and externally borrowing £100m. Internally borrowing will result in an annual saving of £650K on every £100m.

9. Investment Policy and Activity

9.1 The Council held average cash balances of £220 million during the reported period, compared to an average £257 million for the same period last financial year.

Table 2: Movement in Investment Balances 01/04/16 to 31/08/16

	Balance as at 01/04/2016 £'000	Weighted Average Rate of Interest %	Balance as at 31/08/2016 £'000	Weighted Average Rate of Interest %
Short Term Investments	136,495	-	100,995	
Long Term Investments	28,000	-	37,000	
Tradable Instruments	18,772		31,568	
Cash enhanced AAA – rated MMF	8,000		8,000	
AAA-rated Money Market Funds	10,625	-	30,490	
Total	**201,892**	**0.83**	**208,053**	**0.89**

9.2 Due to the volatility of available creditworthy counterparties, longer term investments have been placed in highly rated UK Government institutions. Thus ensuring creditworthiness whilst increasing yield due to the duration of the deposits.

Table 2: Council's Long term investments

Counterparty	Amount	Start date	End date	Days to maturity (as at 31/08/2016)	Rate
Glasgow Council	£5,000,000	15/12/2014	15/12/2016	45	0.97%
Barnsley Metropolitan	£5,000,000	23/04/2014	13/01/2017	74	1.18%
GLA	£5,000,000	14/04/2014	12/02/2017	104	1.50%
Rugby Council	£2,000,000	19/02/2015	14/04/2017	165	1.60%
Newport Council	£3,000,000	08/06/2015	10/07/2017	252	0.95%
Newport Council	£2,000,000	09/02/2015	10/07/2017	252	1.10%
LB of Islington	£3,000,000	31/07/2014	31/07/2017	273	1.30%
Glasgow Council	£5,000,000	15/10/2015	15/01/2018	441	1.00%
Rugby Council	£5,000,000	19/06/2015	19/06/2018	596	1.18%
Darlington Borough	£3,000,000	12/02/2016	12/02/2019	834	1.27%
Highlands Council	£3,000,000	19/04/2016	20/04/2020	1267	1.00%
Newcastle City Council	£3,000,000	11/08/2016	15/02/2019	837	1.05%
Glasgow Council	£5,000,000.	15/12/2014	15/12/2016	45	0.97%

9.3 The Council has also placed two long term investments with Housing Associations. This represents an additional counterparty to the Council and has therefore helped increase both diversification and yield.

9.4 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

9.5 The Council's specific policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital; liquidity of the invested capital; and,
- an optimum yield which is commensurate with security and liquidity.

9.6 The ongoing investment strategy remained extremely cautious but counterparty credit quality remains strong, as can be demonstrated by the Credit Score Analysis summarised below:

Table 2: Credit Score Analysis

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating Score	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating Score
30/04/2016	3.33	AA	3.07	AA
31/05/2016	3.17	AA	2.96	AA+
30/06/2016	3.21	AA	3.87	AA
31/07/2016	3.33	AA	3.91	AA
31/08/2016	3.45	AA	3.84	AA

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 27
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

9.7 The Council continues to utilise AAAmmf/Aaa/AAAm rated Money Market Funds for its very short, liquidity-related surplus balances. This type of investment vehicle has continued to provide very good security and liquidity, although yield suffers as a result.

9.8 In light of legislative changes and bail-in risk for unsecured bank deposits, the Council continues to increase its exposure to high quality corporate bonds. This investment vehicle offers good level of security and increases diversification for the Council's portfolio whilst achieving a reasonable yield.

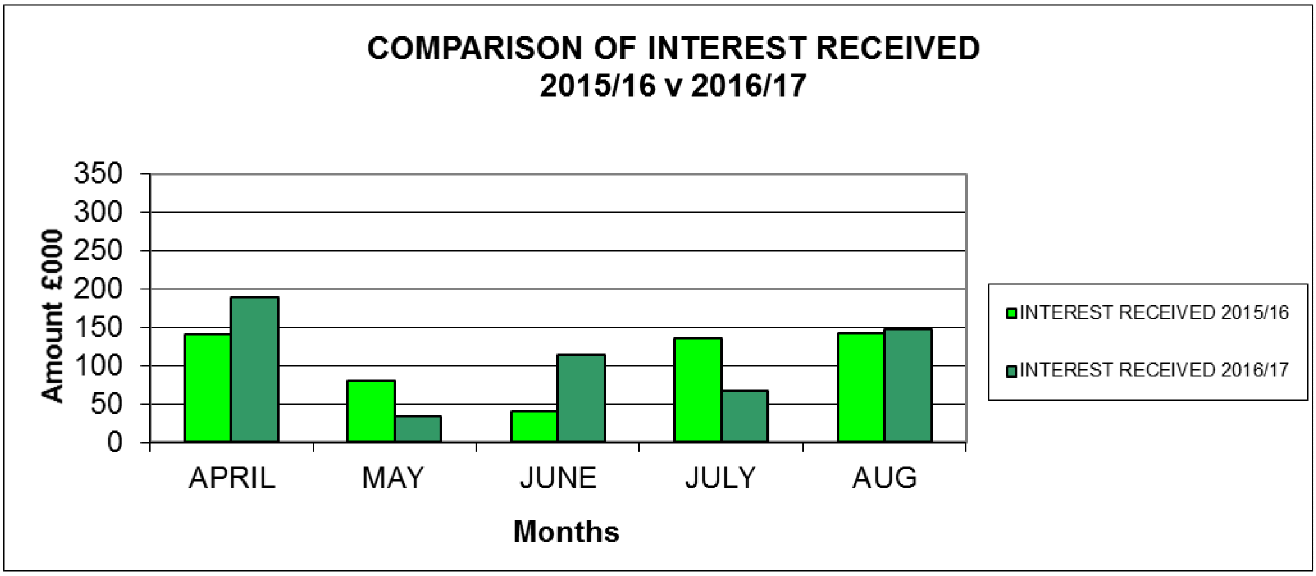
Counterparty	Amount
Daimler	£4,883,015
Motability Operations Group	£4,694,589
Prudential PLC	£4,074,320
Scottish Power	£3,423,417
Total	**17,075,341**

10. Counterparty Update

10.1 Following the UK vote to leave Europe on the 23rd June 2016, there was a significant number of credit rating changes to reflect the uncertain resulting from the referendum result. Most notable, Fitch and S&P downgrading the UK Government (and all associated institutions such as Local Authorities) to AA. In addition, S&P also downgraded the European Union to AA

11. Comparison of Interest Earnings

11.1 The graph below provides a comparison of interest earnings for 2016/17 against the same period for 2015/16



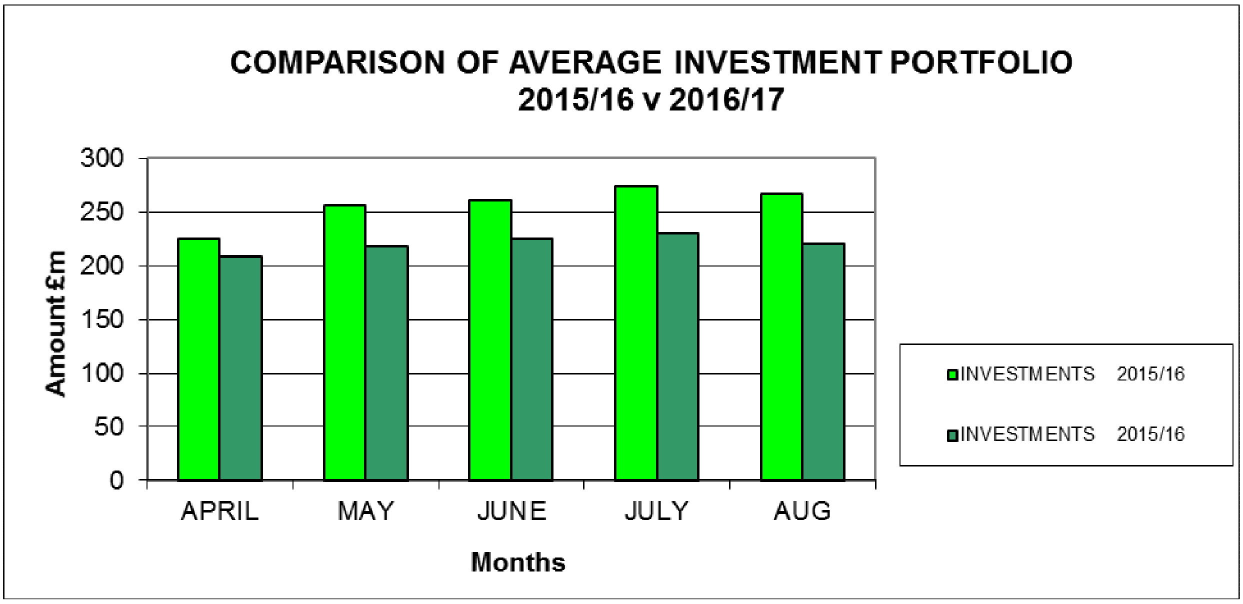
11.2 The graph shows interest earnings continue to remain low due to market interest rates at historically low levels. Average interest received for the period April to August 2016 was £110k compared to £108k for the same period last financial year.

11.3 Although fluctuating on a month by month basis, the interest received has continued to increase on average over the last 2 – 3 years. This increase in interest received is due to the change in approach to treasury. Instead of placing short term deposits, keeping the Council's money very liquid but receiving a low return, the Council has taken a longer view and placed a number of long term deposits, utilising its core cash, and gaining a higher yield.

11.4 However, it should be noted that with the drop in both base rate and gilt yields, it is expecting that interest received will drop in the medium to long term as yields on both Money Market Funds and cash deposits decrease.

12. Movement in Investment Portfolio

12.1 Investment levels have decreased to £220 million at the end of August in comparison to the end of August last year of £267 million. This large balance is still partly due to the large cash injection of the CLG's HRA Reform Settlement Payments Determination, received in 2012/13. The decrease in the investment balance year on year is the result of the continued approach of maintaining borrowing and investments below their underlying levels; internally borrowing to finance capital expenditure.



13. Summary

13.1 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first five months of the financial year 2016/17. As indicated in this report, a prudent approach has been taking in relation investment activity with priority being given to security and liquidity over yield.

APPENDICES
None

BACKGROUND PAPERS
In accordance with The Local Authorities (Executive Arrangements) (Meetings and Access to Information) England Regulations 2012 publication of Background Papers used in the preparation of reports is required

Description of document
None

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