Hackney

TREASURY MANAGEMENT ACTIVITY REPORT 20th January 2017 AUDIT COMMITTEE	Classification: Public
Ward(s) affected None	
Corporate Director Ian Williams, Group Director of Finance & Corporate Resources	

1. INTRODUCTION

1.1 The half year treasury activity report for 2016/17 is the detailed update on the treasury activity for the first six months of the financial year (Appendix 1) and the Q3 treasury activity update for the period October 2016 to December 2016 (Appendix 2).

2. RECOMMENDATION(S)

2.1 The Audit Committee is recommended to:

- **Note the treasury management activity reports at Appendices 1 and 2**

3. REASONS FOR DECISION

3.1 The Treasury Management Half Year Report is required under the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") to be approved along with the Prudential Indicators, The quarterly update at Appendix 2 is presented in accordance with the Council's Treasury Management Strategy.

4. Policy Context

The CIPFA code of practice requires that those charged with oversight receive regular updates on the progress of Council's treasury strategy during the year. Members are being provided with the detailed report on the first six months activity (to September 2016) with an update of the primary treasury indicators along with the Q3 Treasury

Management Report which provides details of activity over during the months of October to December 2016.

4.1 **Equality Impact Assessment**

There are no equality impact issues arising from this report

4.2 **Sustainability**

There are no sustainability issues arising from this report

5. RISK ASSESSMENT

There are no risks arising from this report as the information provided is in respect of past events. Clearly though the treasury management function is a significant area of risk for the Council, if the function is not properly carried out and monitored by those charged with responsibility for oversight of treasury management.

5.1 Consultations

No consultations have taken place in respect of this report.

6. COMMENTS OF THE CORPORATE DIRECTOR OF FINANCE AND CORPORATE RESOURCES

6.1 The half yearly Treasury Activity Report provides an update to this Committee on the treasury activities undertaken on behalf of the Council for the first six months of the current financial year 2016/17. There are no direct financial consequences arising from the report as it reflects the first half year's performance. The information contained in this report will also assist Members of this Committee in monitoring the treasury management activities and enable better understanding of such operations.

6.2 The third quarter's treasury report covers the latest quarter ending December 2016 and reflects the most recent treasury activity.

6.3 Whilst the financial crisis would appear to be receding, the impacts are still being felt in terms of record low interest rates and also how finical institutions are rated and in particular the steps being taken be governments around the globe to bring about stable growth and ensure that risks from banking failures are avoided in the future. The changes highlighted in this report covering changes to the protections for investors in such institutions are likely to impact the Council's treasury strategy for investment going forward and is covered in this report.

7. COMMENTS OF THE DIRECTOR OF LEGAL

7.1 The Accounts and Audit Regulations 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.

7.2 There are no immediate legal implications arising from the report.

8. BACKGROUND

7.1 The half yearly Treasury Activity Report (Appendix 1) provides an update for the Committee on the economic background for the first six months of the current financial year 2016/17. The preliminary estimate of Q2 2016 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, however the UK economic outlook changed significantly on 23rd June 2016. The surprise result of the referendum on EU membership prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy.

7.2 The Council has an increasing Capital Financing Requirement due to the delivery of its capital programme and therefore may need to borrow in future years, depending on the actual level of reserves and cash balances.

7.3 With regard to the investment portfolio, security of capital remains the prime consideration, particularly given the world economy still struggling to pull itself out of recession and the continuing sovereign and institutional downgrades. The average rate of interest received on investments at the end of December 2016 was 0.86%, compared to 0.74% in December 2015. Although Banks continued access to cheap funding, along with the drop in bank rate, keeps money market rates down, the Council has taken a longer term view of its cash balances and interest rates and invested an element of its core cash for a longer duration in highly secure counterparties (Local Authorities). The level of investments outstanding has decreased from £205 million at the beginning of April 2016 to £186 million at December 2016.

APPENDICES

The appendices to this report details the treasury management activities undertaken by the Council. It sets out in detail the economic background in which the treasury management function has had to operate since the beginning of the financial year and the treasury activities which have taken place in the first six months of the financial year to end of September 2016 and for the period October to December 2016.

Appendix 1 – Treasury Management Half Year Activity Report 2016/17

Appendix 2 – Q3 Treasury Management Activity Update Report 2016/17

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Appendix 1

TREASURY MANAGEMENT HALF YEAR ACTIVITY REPORT 2016/17 (6 MONTHS TO 30TH SEPTEMBER 2016)

1. Background

1.1 The Annual Treasury Management Report is a requirement of the Council's reporting procedures and this report covers the treasury activity for the first six months of the financial year 2016/17, 1st April 2016 to 30th September 2016

1.2 The Council's Treasury Management Strategy has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

1.3 The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

1.4 Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.5 The Authority's Treasury Management Strategy for 2016/17 was approved by full Council on 2nd March 2016 and can be accessed on by the following link: http://mginternet.hackney.gov.uk/documents/s47097/TMS%20201617.pdf

1.6 The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

2. Economic Background

2.1 The economy has remained resilient over the last six months despite the political turmoil. The preliminary estimate of Q2 2016 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, as compared to 0.4% in Q1 and year/year growth running at a healthy pace of 2.2%. However the UK economic outlook changed significantly on 23rd June 2016. The surprise result of the referendum on EU membership prompted forecasters to rip up previous projections and dust off worst-case scenarios. Growth forecasts had already been downgraded as 2016 progressed, as the very existence of the referendum dampened business investment, but the crystallisation of the risks and the subsequent political turmoil prompted a sharp decline in household, business and investor sentiment

2.2 The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

2.3 In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. Since the onset of the financial crisis over eight years ago, Arlingclose's rate outlook has progressed from 'lower for longer' to 'even lower for even longer' to, now, 'even lower for the indeterminable future'

3. Debt Management

3.1 The Council had one outstanding long term debt at the start of the financial year; £4m Equal instalment payment loan with the European Investment Bank. The Council undertook no additional borrowing from the start of the year, therefore having the remaining £3.8m EIB as its only borrowing.

3.2 The £3.8m loan relates to 11 year below market rate loan, via the London Energy Efficiency Fund. The money is ring-fenced for communal heating with the final repayment due in December 2025.

3.3 The Authority does not expect to undertake long term borrowing externally in 2016/17. However, the Council may require to externally borrow for short term cash flow purposes.

Table 1: Debt Portfolio positions as at 01/04/2016 and 30/09/2016

	Balance on 01/04/2016 £'000	**Debt Maturing £'000**	**New Borrowing £'000**	**Balance on 30/09/2016 £'000**	**Avg Rate %**
CFR	212,206				
Short Term Borrowing*	0.400	0.200		0.400	1.90%
Long Term Borrowing	3.600			3.400	1.90%
TOTAL BORROWING	4.000	0.200		**3.800**	
Other Long Term Liabilities	15,902			15,902	9.93%
TOTAL EXTERNAL DEBT	**19,902**	0.200		**19,702**	
(Decrease) in borrowing				(0.200)	

* *Loans that mature within 1 year*

3.2 For the Council the use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding capital expenditure. However, this position will not be sustainable over the medium term and the Council expects it will need to borrow for capital purposes in due course.

3.3 **PWLB Borrowing:** The Authority qualifies for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12 month period from 01/11/2016. In April the Authority submitted its application along with the 2016/17 Capital Estimates Return to access this reduced rate for a further 12 month period from 01/11/2016

3.4 **Alternative borrowing sources:** Whilst there are several claims that a competitive, comparable equivalent to long-dated PWLB borrowing is readily available, the Council will continue to adopt a cautious and considered approach to funding from the capital markets when required.

4. Investment Activity

4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Cashflow forecasts indicated that during 2016/17 the Authority's investment balances would range between £180m and £250 million.

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

Table 2: Investment Portfolio positions as at 01/04/2016 and 30/09/2016

	Balance as at 01/04/2016 £'000	**Average Rate of Interest %**	**Balance as at 30/09/2016 £'000**	**Average Rate of Interest %**
Short term Investments* (call accounts, deposits) -Banks and Building Societies with ratings of [A-] or higher -Local Authorities	136,495	-	97,096	-
Long term Investments -Banks and Building Societies with ratings of [A+] or higher -Local Authorities	28,000	-	27,000	-
AAA-rated Stable Net Asset Value Money Market Funds	10,625	-	29,235	-
AAA rated Cash enhanced Variable Net Asset Value Money Market Funds	8,000		8,000	
Corporate and Covered Bonds	18,772		22,793	
Housing Associations	-		10,000	
Financial Institutions without credit ratings			2,000	
	201,892	**0.83**	**196,124**	**0.86**

* *Less than one year*

4.2 Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2016/17. New investments were made with the following institutions:

- Other Local Authorities;
- AAA-rated Stable Net Asset Value Money Market Funds;
- AAA rated Cash enhanced Variable Net Asset Value Money Market Funds
- Deposits with UK Banks and Building Societies systematically important to the UK banking system and with select non-UK Banks Australia, Canada, Finland, Singapore, Germany, Netherlands, Switzerland and the US.
- UK Housing Associations
- Corporate and Covered Bonds
- Unrated UK Building Societies

4.3 Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms /potential support from a well-resourced parent institution and share price.

4.4 Given the increasing risk and continued low returns from short-term unsecured bank investments the Authority has further diversified into more secure and/or higher yielding asset classes such as; covered bonds which are secured on the financial institutions' assets, pooled funds which have the advantage of diversifying investment risks without the need to own and manage the underlying investments, coupled with professional fund management, Housing Associations and sort/medium term Corporate Bonds which are excluded from Bail-in risk.

5. Credit Risk

5.1 Counterparty credit quality remains an important factor in the Council's assessment of approved counterparties. The Council continuously monitors the overall credit quality of its investment portfolio and this is clearly demonstrated by the Credit Score Analysis summarised below. The credit scores are based on the Council's quarter-end in-house investment position.

Table 3: 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
30/06/2016	3.21	AA	3.87	AA
30/09/2015	3.37	AA	3.83	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

6. Counterparty Update

6.1 Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune although the fall in their share prices was less pronounced.

6.2 Fitch downgraded the UK's sovereign rating by one notch to AA from AA+, and Standard & Poor's downgraded its corresponding rating by two notches to AA from AAA. Fitch, S&P and Moody's have a negative outlook on the UK. S&P took similar actions on rail company bonds guaranteed by the UK Government. S&P also downgraded the long-term ratings of the local authorities to which it assigns ratings as well as the long-term rating of the EU from AA+ to AA, the latter on the agency's view that it lowers the union's fiscal flexibility and weakens its political cohesion.

6.3 Moody's affirmed the ratings of nine UK banks and building societies but revised the outlook to negative for those that it perceived to be exposed to a more challenging operating environment arising from the 'leave' outcome.

6.4 The European Banking Authority released the results of its 2016 round of stress tests on the single market's 51 largest banks after markets closed on Friday 29th July. The stress tests gave a rather limited insight into how large banks might fare under a particular economic scenario. When the tests were designed earlier this year, a 1.7% fall in GDP over three years must have seemed like an outside risk. Their base case of 5.4% growth now looks exceptionally optimistic and the stressed case could be closer to reality. No bank was said to have failed the tests. The Royal Bank of Scotland made headline news as one of the worst performers as its ratios fell by some of the largest amounts, but from a relatively high base. Barclays Bank and Deutsche Bank ended the test with Common Equity Tier 1 (CET1) ratios below the 8% threshold, and would be required to raise more capital should the stressed scenario be realised. The tests support our cautious approach on these banks.

6.5 In July Arlingclose, the Council's Treasury Advisors, completed a review of unrated building societies' annual financial statements. Cumberland, Harpenden and Vernon Building Society were removed from Arlingclose's advised list, following a deterioration in credit indicators. The maximum advised maturity was also lowered for eleven societies from 6 months to 100 days due to the uncertainty facing the UK property market following the EU referendum.

7. Compliance with Prudential Indicators

7.1 The Council can confirm that it has complied with its Prudential Indicators for 2016/17, which were set in March 2016 as part of the Council's Treasury Management Strategy Statement.

Compliance with these Indicators is detailed below -

- **Capital Financing Requirement**

Estimates of the Council's cumulative maximum external borrowing requirement for 2016/17 to 2018/19 are shown in the table below:

	31/03/2016 Actual £'000	31/03/2017 Revised £'000	31/03/2018 Revised £'000	31/03/2019 Revised £'000
Gross CFR	227,688	243,385	375,959	453,010
Less: Other Long Term Liabilities	15,482	14,821	14,112	13,349
Borrowing CFR	**212,206**	**228,564**	**361,847**	**439,661**
Less: Existing Profile of Borrowing	4,000	3.600	39,142	122,175
Gross Borrowing Requirement/Internal Borrowing	**208,206**	**228,560**	**322,705**	**317,486**
Usable Reserves	324,439	180,000	100,000	100,000
Net Borrowing Requirement/(Investment) Capacity	**(116,233)**	**48,560**	**222,705**	**217,486**

- **Gross Debt and the Capital Financing Requirement**

In the Prudential Code Amendment (November 2012), it states that the chief finance officer should make arrangements for monitoring with respect to gross debt and the capital financing requirement such that any deviation is reported to him/her, since any such deviation may be significant and should lead to further investigation and action as appropriate.

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with **gross** external debt.

	31/03/2016 Actual £'000	31/03/2017 Revised £'000	31/03/2018 Revised £'000	31/03/2019 Revised £'000
CFR	212,206	228,564	361,847	439,661
Gross Debt	4,000	3.600	39,142	122,175
Borrowed in excess of CFR? (Yes/No)	**No**	**No**	**No**	**No**

The Group Director of Finance and Corporate Resources reports that the Authority had no difficulty meeting this requirement in 2016/17 (to date), nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

- **Usable Reserves**

Estimates of the Council's level of Usable Reserves for 2015/16 to 2018/19 are as follows:

	31/03/2016 Actual £'000	31/03/2017 Revised £'000	31/03/2018 Revised £'000	31/03/2019 Revised £'000
Usable Reserves	324.439	180.000	100.000	100.000

- **Estimates of Capital Expenditure**

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax and in the case of the HRA, housing rent levels.

Capital Expenditure	31/03/2016 Actual £'000	31/03/2017 Revised £'000	31/03/2018 Revised £'000	31/03/2019 Revised £'000
Non-HRA	74,348	130,805	177,077	115,429
HRA	91,872	103,088	186,929	246,491
Total	**166,220**	**233,893**	**364,006**	**361,920**

Capital expenditure will be financed or funded as follows:

Capital Financing	31/03/2016 Actual £'000	31/03/2017 Revised £'000	31/03/2018 Revised £'000	31/03/2019 Revised £'000
Borrowing - Supported	9.692			
Borrowing - Unsupported	-	19.948	136.394	84.799
S106	8.545	6.261	0.774	0
Capital receipts	10.331	68.64	104.885	206.281
Grants	25.297	23.051	27.451	6.718
Reserves	12.452	11.653	7.265	3.887
RCCO	55.816	38.606	50.000	48.700
Discretionary	44.086	65.732	37.237	11.535
Total Financing	**166.220**	**233.893**	**364.006**	**361.920**

The table above shows that the capital expenditure plans of the Authority cannot be funded entirely from sources other than external borrowing.

- **Ratio of Financing Costs to Net Revenue Stream:**

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2015/16 Approved %	2016/17 Revised %	2017/18 Revised %	2018/19 Revised %
Non-HRA	1.41%	2.61%	4.17%	4.33%
HRA	3.42%	1.95%	2.28%	1.27%

Note – approved has interest as the only financing cost

- **Capital Financing Requirement**

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing.

Capital Financing Requirement	2015/16 Approved £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000
CFR – Non Housing	157,530	135,371	217,844	274,657
CFR – Housing	60,078	108.014	158.115	178.353
Total CFR	**217,608**	**243,385**	**375,959**	**456,996**

- **Incremental Impact of Capital Investment Decisions**

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2016/17 £	2017/18 Estimate £	2018/19 Estimate £
Increase in Band D Council Tax	0	0	30.55
Increase in Average Weekly Housing Rents	0	0	(1.01)

The Council's capital plans, as estimated in forthcoming financial years, have a neutral impact on council tax and/or housing rents. This reflects the fact that capital expenditure is predominantly financed from internal resources (grants, contributions, revenue and capital receipts). There is therefore no effect on Council Tax or Housing Rents. The other possible revenue consequences of the capital programme such as running costs are also assumed to be revenue neutral in this calculation.

- **Authorised Limit and Operational Boundary for External Debt**

  The Local Government Act 2003 requires the Council to set an **Authorised Borrowing Limit**, irrespective of their indebted status. This is a statutory limit which should not be breached.

  The Council's **Authorised Borrowing Limit** was set at **£267m for 2015/16**.

  The **Operational Boundary** is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

  The **Operational Boundary for 2015/16 was set at £237 m.**

  The Group Director of Finance and Corporate Resources confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year; and borrowing at its peak was £4.0m.

	Authorised Limit (Approved) as at 31/03/2016 £m	**Operational Boundary (Approved) as at 31/03/2016 £m**	**Actual External Debt as at 30/09/2016 £m**
Borrowing	267,607	237,607	4.000
Other Long-term Liabilities	0	0	15,904
Total	267,607	237,607	19.904

- **Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure**

  These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

  The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2016/17 £'000
Upper Limit for Fixed Rate Exposure	80,000
Compliance with Limits:	**Yes**
Upper Limit for Variable Rate Exposure	20,000
Compliance with Limits:	**Yes**

- **Maturity Structure of Fixed Rate Borrowing**

  This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	**Lower Limit %**	**Upper Limit %**	**Actual Fixed Rate Borrowing as**	**% Fixed Rate Borrowing**	**Compliance with Set**

			at 30/09/16	as at 30/09/16	Limits?
under 12 months	0	100	400	10.53%	Yes
12 months and within 24 months	0	100	400	10.53%	Yes
24 months and within 5 years	0	100	1,200	31.57%	Yes
5 years and within 10 years	0	100	1.800	47.37%	Yes
10 years and within 20 years	0	100	0	0	Yes
20 years and within 30 years	0	100	0	0	Yes
30 years and within 40 years	0	100	0	0	Yes
40 years and within 50 years	0	100	0	0	Yes
50 years and above	0	100	0	0	Yes

- **Total principal sums invested for periods longer than 364 days**

  This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

  The limit for 2016/17 was set at £80m.

  During the reporting period, the Council had a total of £28m in a fixed term investment over 365 years.

  In addition, the Council had £7.8 million in Covered Bonds for longer than 365 days. Although these bonds could be sold through the market at any point, the Council implements a buy and hold strategy and therefore will hold these bonds until they mature.

- **Credit Risk**

  This indicator has been incorporated to review the Council's approach to credit risk. The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions.

  Credit ratings remain an important element of assessing credit risk, but they are not the sole feature in the Authority's assessment of counterparty credit risk. The authority considers the following tools to assess credit risk:

  - Published credit ratings of the financial institution and its sovereign;
  - Sovereign support mechanisms;
  - Credit default swaps (where quoted);
  - Share prices (where available);
  - Economic fundamentals, such as a country's net debt as a percentage of its GDP);
  - Corporate developments, news, articles, markets sentiment and momentum.

  The Council can confirm that all investments were made in line with minimum credit rating criteria set in the 2016/17 TMSS.

- **HRA Limit on Indebtedness**

  This purpose of this indicator is for the Council to report on the level of the limit imposed at the time of implementation of self-financing by the Department for Communities and Local Government.

HRA Limit on Indebtedness	2016/17 Approved £m	31/03/2017 Revised £m	31/03/18 Revised £m	31/03/19 Revised £m
HRA Debt Cap	178,353	178,353	178,353	178,353
HRA CFR	69.770	108.014	158.115	178.353
Difference (Additional Borrowing Capacity for the HRA)	108.583	70.339	20.238	0

10. Summary

10.1 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 two quarters of 2016/17. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Appendix 2

Q3 TREASURY MANAGEMENT UPDATE 2016/17 (OCTOBER 2016 to DECEMBER 2016)

1. Economic Highlights in Q3 2016/17

- **Growth**: The third estimate of Q3 GDP showed the UK economy expanded by 0.6% over the quarter and 2.2% year-on-year.

- **Inflation**: UK Inflation is currently on and upwards trend, rising 0.9% in November to 1.2%. Despite this, inflation remains below the target level of 2%.

- **Monetary Policy:** Following the recent change in bank rate and asset purchase program in July, Monetary Policy Committee voted unanimously to maintain Bank Rate at 0.25%. The Committee also voted unanimously to continue with the programme of £60 billion of UK government bond and £10 billion of corporate bond purchased announced in August.

2. Borrowing & Debt Activity

2.1 The Authority currently has £3.6m in external borrowing. This is made up of a single £3.6m London Energy Efficiency Fund (LEEF) loan from the European Investment Bank to fund housing regeneration.

2.2 Close analysis of the Council's cashflow requirements and its Capital Financing Requirement (CFR is an indicator of the overall need to borrow), as it is currently known, indicates that new borrowing, including borrowing proposed in the HRA business plan, may be required in the next 3 years.

3. Investment Policy and Activity

3.1 The Council held average cash balances of £200 million during the three month period, compared to £250 million for the same period last financial year.

Table 1: Movement in Investment Balances 01/10/16 to 31/12/16

	Balance as at 01/10/2016 £'000	**Average Rate of Interest %**	**Balance as at 31/12/2016 £'000**	**Average Rate of Interest %**
Short term Deposits	97,096	-	72,619	
Long term Deposits*	27,000	-	31,500	
AAA-rated Stable Net Asset Value Money Market Funds	29,235	-	33,745	
AAA rated Cash enhanced Variable Net Asset Value Money Market Funds	8,000		8,000	
Corporate and Covered Bonds	22,793		24,713	
Housing Associations	10,000		15,000	
Financial Institutions without credit ratings	2,000		2,000	
	196,124	**0.86**	**185,578**	**0.84**

*deposits with over a year until maturity

3.2 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.

3.3 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.

3.4 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 3: 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
31/10/2016	3.18	AA	4.18	AA-
30/11/2016	3.22	AA	3.63	AA
31/12/2016	3.17	AA	3.64	AA

-Value we-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

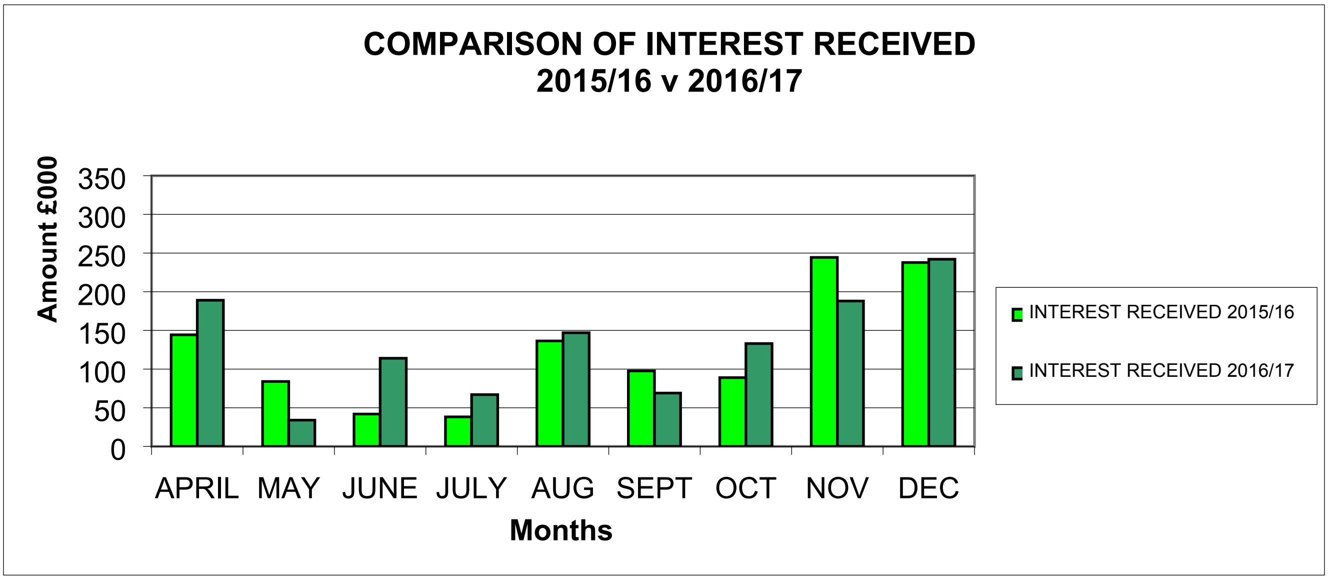
3.5 The Council continues to utilise AAAmmf/Aaa/AAAm rated Money Market Funds for its very short, liquidity-related surplus balances, together with high credit rated call accounts. This type of investment vehicle has continued to provide very good security and liquidity, although yield has suffered in recent months

4. Comparison of Interest Earnings

4.1 The Council continues to adopt a fairly cautious strategy in terms of investment counterparties and periods. Due to the volatility of available creditworthy counterparties, longer term investments have been placed in highly rated UK Government institutions or Covered (secured) Bonds. Thus ensuring creditworthiness whilst increasing yield’s through the duration of the deposits.

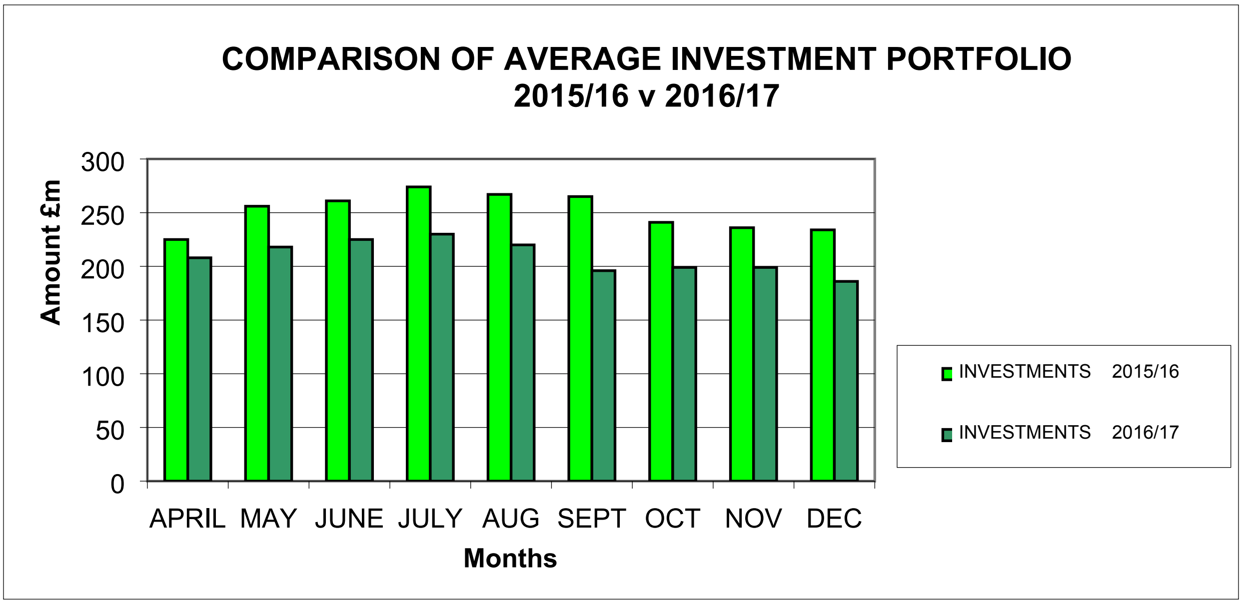
4.2 The graph below provides a comparison of interest earnings for 2016/17 against the same period for 2015/16. The graph highlights that the Council’s longer term investment approach is paying dividends with high levels on interest received when taking into account the investment market environment.

Average interest received for the period October to December 2016 was £188k compared to £190k for the same period last financial year.



5. Movement in Investment Portfolio

5.1 Investment levels have decreased to £186 million at the end of December In comparison to the same period last year of £234 million.



7. Summary

7.1 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 third quarter 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.