TREASURY MANAGEMENT ACTIVITY REPORT 2016/17 (1st June 2017 – 31st August 2017) **13th September 2017** **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 update on Treasury Management activities for the reported period June 2017 to August 2017.

2. Recommendation(s)

The Audit Committee is recommended to:

- **Note the report**

3. Background

This report is the second of the treasury reports relating to the financial year 2017/18 for the Audit Committee. It sets out the background for treasury management activity from June 2017 to August 2017 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 June 17 to August 2017. Whilst investment interest is not used to underpin the Council's base revenue budget, as in some other authorities, the levels achieved will have 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:** Q1 and Q2 GDP data showed economic activity growing at a much slower pace of 0.2% and 0.3% respectively, the services sector providing the main boost to growth. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these constrains will limit growth in the second half of calendar year 2017.

- **Inflation:** UK Consumer Price Inflation (CPI) index rose with the data print for May showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. Thereafter, however, CPI has fallen back to 2.6% in July which is in line with the Bank of England's estimate published in its August Inflation Report. The new inflation measure CPIH, which includes owner occupiers housing costs, was also 2.6%. The most recent labour market data for June 2017 showed that the unemployment rate had fallen further to 4.4%, its lowest since July 1975 but that the squeeze on real wages (i.e. after inflation) is intensifying with average earnings growing at 2.1%.

- **Monetary Policy:** Bank of England made no change to monetary policy at its meetings this year, although the vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth.

In the face of a struggling economy and Brexit-related uncertainty, it's expected that Bank of England will look through periods of high inflation and maintain its low-for-longer stance on policy interest rates for an extended period.

8. Borrowing & Debt Activity

8.1 The Authority currently has just a £3.4m LEEF loan from the European Investment Bank to fund housing regeneration, having now repaid the short term borrowing that was required to cashflow the purchase of the Morning Lane site as set out in previous reports

8.2 Close analysis of Councils Capital Financing Requirement (CFR is an indicator of an overall need to borrow) as it is currently known indicates that further borrowing including borrowing proposed in the HRA business plan, will be required within the next three years.

9. Investment Policy and Activity

9.1 The Council held average cash balances of £140 million during the reported period, compared to an average £218 million for the same period last financial year. This reduction is largely due to the capital expenditure incurred on the purchase of the Morning Lane site and the subsequent repayment of the short term borrowing associated with this transaction.

Movement in Investment Balances 01/06/17 to 31/08/17

	Balance as at 01/06/2017 £'000	**Average Rate of Interest %**	**Balance as at 31/08/2017 £'000**	**Average Rate of Interest %**
Short term Deposits	41,167	-	35,182	
Long term Deposits	24,500	-	19,500	
AAA-rated Stable Net Asset Value Money Market Funds	88,290	-	21,950	
AAA rated Cash enhanced Variable Net Asset Value Money Market Funds	3,000		3,000	
Corporate and Covered Bonds	19,638		19,638	
Housing Associations	15,000		15,000	

Financial Institutions without credit ratings	2,000		2,000	
	193,595	**0.63**	**116,270**	**0.83**

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.

9.3 The Council has also placed three long term investments with Housing Associations assisting 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.

10. Counterparty Update

10.1 There were a few credit rating changes during the period. Moody's placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide and Coventry building societies from negative to stable following improvement to their asset quality, but downgraded the long-term rating of Leeds BS from A2 to A3. As a general update (not affecting Hackney's portfolio) Moody's downgraded the major Canadian banks' long-term ratings on the agency's expectation of a more challenging operating environment for the banks for the remainder of 2017 and beyond that could lead to a deterioration in the banks' asset quality and increase their sensitivity to external shocks. Moody's downgraded the ratings of the large Australian banks to Aa3 from Aa2 reflecting the agency's view of the rising risks from the banks' exposure to the Australian housing market and the elevated proportion of lending to residential property investors.

S&P also revised Nordea Banks outlook to stable from negative, whilst affirming their long-term rating at AA-. The outlook revision reflects Nordea's geographic diversification and strong financials. The agency also upgraded the long-term rating of ING Bank from A to A+.

10.2 Whilst the ongoing investment strategy remained cautious counterparty credit quality remains relatively strong, as can be demonstrated by the Credit Score Analysis summarised below:

Credit Score Analysis

Date	Value Weighted Average – Credit Risk	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk	Time Weighted Average – Credit Rating

	Score	Score	Score	Score
30/06/2017	4.3	AA-	3.6	AA-
31/07/2017	4.4	AA-	3.6	AA-
31/08/2017	4.3	AA-	3.6	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

10.3 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.

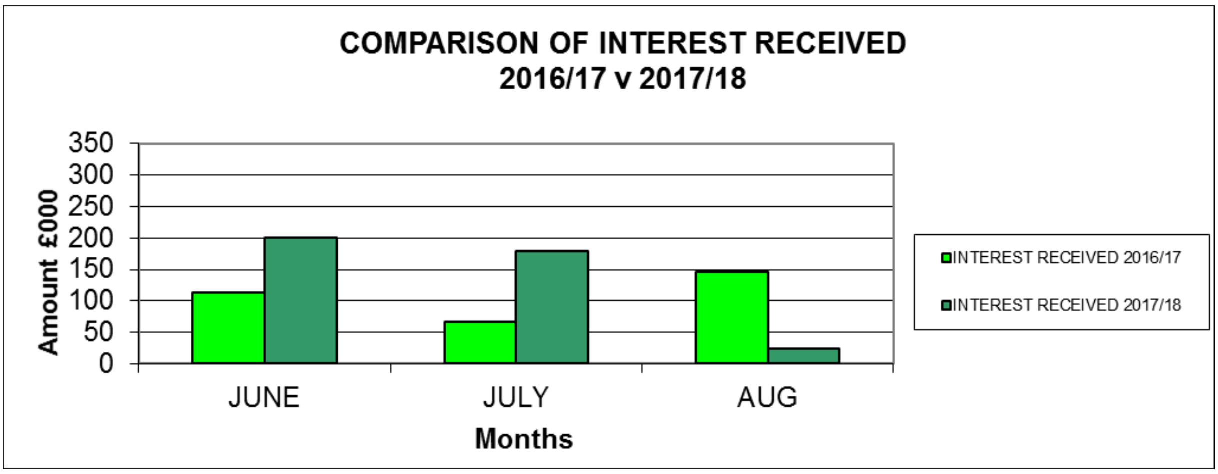
10.4 In light of legislative changes and bail-in risk for unsecured bank deposits, as set out in previous monitoring reports, the Council continues to invest in high quality corporate bonds. This investment vehicle offers good level of security and increases diversification for the Council's portfolio whilst achieving a reasonable yield.

11. Comparison of Interest Earnings

11.1 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.

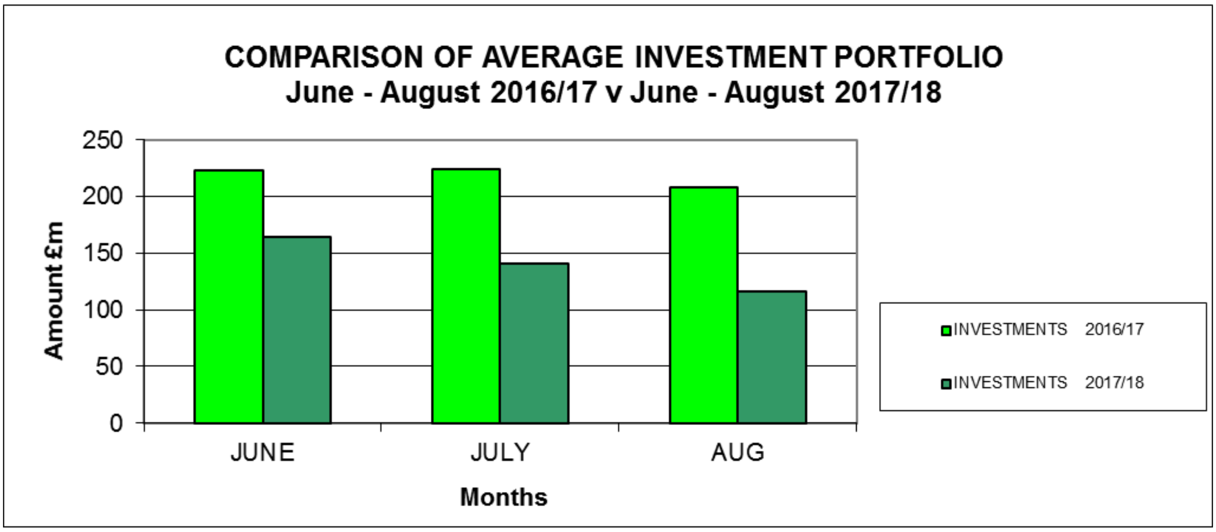
11.2 The graph below provides a comparison of interest earnings for 2017/18 against the same period for 2016/17. The graph highlights that the Council's longer term investment approach is paying dividends with higher levels on interest received when taking into account the investment market environment.

Average interest received for the period June 17 to August 2017 was £135k compared to £109k for the same period last financial year.



12. Movement in Investment Portfolio

12.1 Investment levels have decreased to £116 million at the end of August in comparison to the end of March last year of £149 million. 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 i.e. use of internal borrowing.



13. Regulatory Update: MiFID II Update

The way that local authorities can access financial services will change in January 2018 as a result of the second Markets in Financial Instruments Directive. Following a consultation last year, rules just published confirm that local authorities can only continue to be classed as professional clients if they have at least a £10m investment balance and staff with relevant experience. Local authorities not meeting the criteria will be reclassified as retail clients, which may mean reduced access to financial services or higher fees and greater administrative burden.

Over the next few months, firms (Financial Institutions) that provide financial services in regulated investments (e.g. bonds and funds, but not deposits or loans) will be in touch to invite authorities to opt up to professional status and to demonstrate that they meet the required criteria. Officers do not believe that the Council will have any issues in opting up to professional status given its investment portfolio and experience in investment transactions.

Authorities that wish to retain the limited protections available to retail clients or who are unable to meet the opting up criteria will need to check to see which of their service providers are (or intend to become) authorised to serve retail clients, and if necessary start to procure alternatives.

14. 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 reported period June 17 to August 17 of the financial year 2017/18. 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.

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