POLICY, RESOURCES & GROWTH COMMITTEE	Agenda Item 81 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement 2016/17 (including Annual Investment Strategy 2016/17) – Mid Year Review**	
Date of Meeting:		**8 December 2016**	
Report of:		**Report of the Executive Director for Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 29-1242**
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Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2016/17 Treasury Management Policy Statement (TMPS), practices and schedules were approved by Policy & Resources Committee on 17 March 2016. The TMPS sets out the role of Treasury Management, whilst the practices and schedules set out the annual targets and methods by which these targets will be met.

1.2 The TMPS includes the Annual Investment Strategy (AIS) which sets out the key parameters for investing council cash funds and was approved by Full Council on 24 March 2016.

1.3 It is recommended good and proper practice that Members receive half yearly reports and review and endorse treasury management actions during the year. The purpose of this report is to advise of the action taken in the first half of 2015/16.

2. RECOMMENDATIONS:

2.1 That Policy, Resources & Growth Committee endorses the key actions taken during the first half of 2016/17 to meet the treasury management policy statement and practices (including the investment strategy) as set out in this report.

2.2 That Policy, Resources & Growth Committee notes that the approved maximum indicator for investment risk of 0.05% has been adhered to and the authorised limit and operational boundary have not been exceeded in the first half of the year.

3. CONTEXT/ BACKGROUND INFORMATION

Overview of Markets

3.1 There has been considerable volatility in markets following the EU Referendum result. Initial market shocks led to the Monetary Policy Committee cutting interest rates from 0.50% to 0.25% and implementing financial stimulus measures including an extension of quantative easing. The Bank of England Governor, Mark Carney, highlighted that further support measures could be introduced to ease market sentiment. Since the measures introduced by the Bank of England in August 2016, surveys have shown a recovery in confidence, with growth expectations and confidence appearing to be stronger than originally forecast. However, fresh currency falls have driven up gilt yields and triggered concerns about rising inflation. As a result, markets are no longer pricing in further official rate cuts by the Bank of England.

3.2 The reduction in the Bank Rate has impacted on the investment rates that the council is able to access, particularly for short term investments. For example, Money Market Funds that the council uses have reduced from an average investment rate of 0.52% to around 0.32%. Officers had undertaken a number of longer term investments (up to one year) prior to the rate reduction which is protecting the average yield that will be achieved in 2016/17. However the overall rate of return of the council's investment portfolio will reduce as these investments mature. This will cause a pressure in 2017/18 which will be considered as part of the budget setting process. Officers are also closely monitoring cash flow forecasts to ensure funds are invested for an appropriate time horizon to ensure value is achieved.

Treasury Management Strategy

3.3 A summary of the action taken in the 6 months to September 2016 is provided in Appendix 1 to this report and further information on borrowing and investment performance is shown in the September 2016 Bulletin at Appendix 2. The main points are:

- The council entered into £19.322m of new borrowing arrangements during the period: £4.322m to support the construction of the i360, £5.000m to externalise borrowing where the General Fund was borrowing from it's own reserves (i.e. 'under-borrowing'), and £10.000m to support the HRA Capital Programme;
- The highest risk indicator during the period was 0.037% which is below the maximum set of 0.050%;
- The return on investments by the in-house treasury team and cash manager has exceeded the target rates.
- The two borrowing limits approved by full Council have not been exceeded.

3.4 Treasury management activity in the half-year has focused on a short-term horizon as summarised in the table below:

	Amount invested 1 Apr 2016 to 30 Sep 2016			
	Fixed deposits	Money market funds & Call Accounts	Total	
Up to 1 week	-	£234.6m	£234.6m	87%
Between 1 week & 1 month	-	-	-	-
Between 1 month & 3 months	£10.5m	-	£10.5m	4%
Over 3 months	£20.7m	£4.5m	£25.2m	9%

	£33.2m	**£239.1m**	**£270.3m**	**100%**

Summary of Treasury Activity April to September 2016

3.5 The following table summarises the treasury activity in the half year to September 2016 compared to the corresponding period in the pervious year.

April to September	2015/16	2016/17
Long-term borrowing entered into	(£12.0m)	(£19.3m)
Long-term borrowing repaid	£0.2m	£3.4m
Short-term borrowing repaid	-	-
Investments made	£273.6m	£270.3m
Investments maturing	(£255.3m)	(£246.8m)

3.6 The Financing Costs budget reported a £0.100m saving at Month 5. This includes a £0.150m saving due to an increase in investment income resulting from an increase in both cash balances and average rates received, which was offset by a £0.050m pressure as a result of bringing forward future years' borrowing to take advantage of attractive long term rates.

3.7 The following table summarises how the day-to-day cash flows in the first half-year have been funded compared to the same period in the previous year.

April to September	2015/16	2016/17
Cash flow surplus – general	£8.0m	£7.2m
Net cashflow surplus	**£8.0m**	**£7.2m**
Represented by: Increase in long-term borrowing Decrease in short-term borrowing Increase in investments (Increase)/decrease in bank balance	 £11.8m (£2.0m) (£18.3m) £0.5m	 £15.9m - (£23.5m) £0.4m

Security of Investments

3.8 A summary of investments made by the in-house treasury team and outstanding as at 30 September 2016 in the table below shows that investments continue to be held in good quality, short term instruments. The funds invested in BBB institutions included in the table below are invested in the part-nationalised banks which are backed by Government guarantees in line with the AIS.

'AAA' rated money market funds	£9.83m	13%
'AA' rated institutions	£3.00m	4%
'A' rated institutions	£62.27m	80%
'BBB' rated institutions	£2.50m	3%
Total	**£77.60m**	**100%**
Period – less than one week	£9.83m	13%
Period – between one week and one month	£6.00m	8%
Period – between one month and three months	£12.53m	16%
Period – between three months and 1 year	£49.24m	63%
Total	**£77.60m**	**100%**

Risk

3.9 As part of the investment strategy for 2016/17 the Council agreed a maximum risk benchmark of 0.050% i.e. there is a 99.95% probability that the council will get its investments back. The benchmark is a simple target that measures the risk based on the financial standing of counterparties and length of each investment based on historic default rates. The actual risk indicator has varied between 0.027% and 0.037% between April 2016 and September 2016. It should be remembered however that the benchmark is an average risk of default measure, and does not constitute an expectation of loss against a particular investment.

3.10 In January 2016, Internal Audit undertook an audit of the treasury management function. The audit concluded that “reasonable assurance” is provided on the effectiveness of the control framework operating and mitigating risks for treasury management. Action has been undertaken to address the recommendations of the audit.

Performance

3.11 The following table summarises the performance on investments compared with the budgeted position and the benchmark rate.

(*) Annualised rates	In-house investments		Cash manager investments	
	Average balance	Average rate (*)	Average balance	Average rate (*)ˆ
Budget 2016/17– full year*	£66.1m	0.60%	£25.7m	1.00%
Actual to end Sept 2016	£89.8m	0.80%	£25.8m	1.32%
Benchmark rate (i.e. 7 day LIBID Rate) to end Sept 2016	-	0.28%	-	0.32%

** This is an average for the full year –profile of balances are higher in the first half of the year and are expected to reduce over the financial year*
ˆThe Cash Manager average rates are gross of fees. Fees are deducted at 0.15%

3.12 The return on the cash manager funds had been declining, which triggered a review and options appraisal by officers, supported by the council’s treasury advisors. Officers reported to Budget Review Group in September 2016 to outline intentions and the next step to the review. The options appraisal concluded that a formal selection process should be undertaken to ensure value for money and security is being obtained from the funds. Officers will be asking Capita Asset Services to undertake a selection process for Corporate Bond Funds and Enhanced Cash Funds. The council is able to provide the investment parameters for the selection process, including an “ethical overlay” to ensure potential funds meet the council’s ethical investment policy. The cost of this process will be approximately £2,500 which will be met by the Financing Costs budget.

3.13 The options review also concluded that direct investment into corporate bonds was an appropriate alternative to diversify the council’s portfolio. The 2017/18 Annual Investment Strategy will be amended to define the investment criteria and parameters for investment into corporate bonds.

3.14 Since the review was undertaken, the cash manager’s return has improved significantly, but this is likely to be a short term effect of the increase in value of the assets of the portfolio as a result of a decrease in the yield arising from the fall in interest rates. Officers will closely monitor the trend of the return. The selection process will be delayed until officers are confident that the improvement is a short term issue.

3.15 The council is part of a regional benchmark club which shares investment strategies and performance on a confidential basis. The latest benchmarking data demonstrates that the council's investment portfolio is performing well in a challenging investment climate.

Borrowing Strategy

3.16 Over recent years the council has been following a strategy of repaying debt and funding its borrowing requirement through utilising cash balances which were supporting the council's reserves and balances. This is a prudent strategy which has allowed the council to minimise the cost of carry on its borrowing, and reduce its counterparty exposure risk. The approach changed in 2015/16, and the strategy included undertaking £20m of General Fund borrowing over the next 4 years to reduce the council's under-borrowing position. This was to take advantage of low interest rates at a time where interest rates were expected to rise in the medium term. Additionally, reserves forecasts demonstrated that certain reserves supporting the under-borrowing position are expected to be drawn down in the Medium Term Financial Plan.

3.17 To aid the decision as to whether or not to borrow, an analysis of interest rate projections was undertaken with the council's treasury advisers to determine 'trigger rates' that would be closely monitored. Following the trigger rates being activated in 2015/16, £15.0m of this borrowing requirement was undertaken. Further trigger rates were set and activated in 2016/17 for both the General Fund and the HRA and a further £5.0m of General Fund borrowing was undertaken to reduce the under borrowing as well as £10.0m HRA borrowing to fund the 2016/17 capital programme.

3.18 Bringing forward the General Fund borrowing requirement has allowed the council to undertake borrowing at attractive long term rates. There is a short term additional cost of bringing this borrowing forward which has been included in the Financing Costs budget projections. The General Fund's average cost of borrowing (excluding i360) has reduced from 4.82% to 4.46% which creates permanent revenue savings of £86,000.

Treasury Advisors

3.19 The council's current contract for treasury advisory services is with Capita Asset Services.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the 6 months to September 2016. Treasury management actions have been carried out within the parameters of the AIS, TMPS and Prudential Indicators. Therefore no alternative options have been considered.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted over the content of this report. No other consultation was necessary.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The Code requires a minimum of two reports per year, one of which is required to review the previous year's performance. This report fulfils that requirement.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The financial implications of treasury management activity are reflected in the financing costs budget set out in paragraph 3.6.

Finance Officer Consulted: James Hengeveld Date: 04/11/16

Legal Implications:

7.2 The TMPS and associated actions are exercised under powers given to the council by Part 1 of the Local Government Act 2003 which includes the power for a local authority to invest for the purposes of the prudent management of its financial affairs (section 12).

Lawyer Consulted: Elizabeth Culbert Date: 14.11.16

Equalities, Sustainability and other significant implications:

7.3 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices:

1. A summary of the action taken in the period April 2016 to September 2016
2. September 2016 Treasury Management Bulletin

Documents in Members' Rooms

None

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations
2. The Treasury Management Policy Statement and associated schedules 2016/17 approved by Policy & Resources Committee on 17 March 2016
3. The Annual Investment Strategy 2016/17 approved by full Council on 24 March 2016
4. Treasury Management Policy Statement 2015/16 (including Annual Investment Strategy 2015/16) – End of year Review approved by Policy, Resources & Growth Committee on 14 July 2016
5. Papers held within Financial Services, Finance & Resources Directorate
6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2011