Council **21 July 2016**	Agenda Item 22 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement 2015/16 – End of year review**	
Date of Meeting:		**14 July 2016**	
Report of:		**Executive Director for Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 29-1242**
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Ward(s) affected:		**All**	

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1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 The 2015/16 Treasury Management Policy Statement (TMPS), practices, and schedules were approved by the Policy & Resources Committee on 19 March 2015. 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 balances and was approved by Full Council on 26 March 2015, and subsequently amended by Full Council on 16 July 2015.

2. RECOMMENDATIONS

2.1 That Policy, Resources & Growth Committee endorses the key actions taken during the second half of 2015/16 to meet the TMPS and practices (including the investment strategy) as set out in this report.

2.2 That Policy, Resources & Growth Committee notes the reported compliance with the AIS for the period under review.

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

3. CONTEXT/ BACKGROUND INFORMATION

Overview of the markets

3.1 Much of the focus in the current economic landscape has been on the impact of the outcome of the EU referendum. Appendix 3 outlines the views of the council's treasury advisors, Capita Asset Services, and provides their view on the interest rate and economic outlook going forward. There is a large degree of both political and economic uncertainty post-referendum, which has had a number of impacts in the markets and in the responses from the Bank of England and the credit reference agencies.

3.2 The UK's credit rating has been downgraded by credit ratings agency Standard & Poor, which was the last of the three credit reference agencies to remove the UK's AAA rating. Additionally, Moody's has changed its outlook on the UK Banking System from stable to negative, placing a number of UK banks at risk of future downgrades. Banking reforms that have been phased in since 2013 have resulted in banks having stronger balance sheets and healthier liquidity. Nevertheless, counterparty risk remains a concern, and the Treasury Management Team continues to closely monitor the approved list of counterparties.

3.3 The governor of the Bank of England, Mark Carney, gave a speech on 1July which made it clear that the Monetary Policy Committee would give consideration to further reductions in the Bank Rate, as well as further use of Quantative Easing. Uncertainty for the longer term has already had the effect of a reduction in yields offered by the council's counterparties. It is therefore expected that the Financing Costs budget will come under pressure during 2016/17 in respect of investment interest income. This will be monitored and reported as part of the normal TBM process.

Treasury Management Strategy

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

- The council entered into £23.506m of new borrowing arrangements during the period: £8.506m of which was to support the construction of the i360 and £15.000m was to externalise borrowing where the General Fund is currently borrowing cash from its own reserves (i.e. 'under-borrowing');
- The highest risk indicator during the period was 0.033% which is below the maximum set of 0.050%;
- The return on investments by the in-house team and cash manager has exceeded the target rates;
- The two borrowing limits approved by full Council have not been exceeded.

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

	Amount invested 1 Oct 2015 to 31 Mar 2016			
	Fixed deposits	Money market funds	Total	
Up to 1 week	-	£233.9m	£233.9m	84%
Between 1 week & 1 month	-	-	-	0%
Between 1 month & 3 months	£1.5m	£4.5m	£6.0m	2%
Over 3 months	£32.3m	£5.4m	£37.7m	14%
	£33.8m	**£243.8m**	**£277.6m**	**100%**

Budget versus Outturn 2015/16

3.6 The following table summarises the performance achieved on investments compared to the budgeted position and approved benchmark for the whole year.

	In-house Investments		Cash Manager investments (net of fees)	
	Average Balance	Average rate	Average Balance	Average rate
Budget 2015/16	£57.0m	0.60%	£25.6m	0.85%
Actual 2015/16	£83.5m	0.68%	£25.6m	0.61%
Benchmark Rate		0.36%		0.36%

3.7 The Financing Costs budget variance in 2015/16 was £2.624m underspent of which £2.328m was due to a reduced Minimum Revenue Provision (MRP) as a result of a change in MRP policy (approved by Budget Council on 25 February 2016). The revised policy has effectively re-profiled the MRP resulting in a smoother profile which has in turn freed up revenue budget in the short to medium term.

3.8 The remaining £0.296m is primarily as a result of increased investment income due a combination of higher than projected cash balances and an increase in the average investment rate (£0.229m). The remaining underspend is as a result in an amendment in the borrowing strategy during the year as detailed in 3.15 to 3.17. A combination of lower than anticipated borrowing rates and the postponement of borrowing until later in the year has resulted in an in-year saving of £0.080m. There were a number of other small savings totalling £0.045m.

3.9 These savings are offset by a poorer performance than anticipated from the cash manager fund during the year (£0.058m). As reported to Policy & Resources Committee and full Council in March 2016, officers are exploring other investment options for the funds currently held with the Cash Managers. A separate report is expected to be presented to the Budget Review Group to recommend preferred options in September 2016. There is no perceived urgency in divesting from the cash manager’s fund as the security of the fund remains AAA rated and returns have improved since March 2016. As always with investment activity, there is also a need to take a balanced approach to ensure a level of diversity in investment activities, which helps to minimise risk should one activity under-perform.

Summary of Treasury Activity October 2015 to March 2016

The following table summarises the treasury activity in the half year to March 2016 compared to the corresponding period in the previous year:

October to March	2013/14	2014/15	2015/16
Long-term borrowing raised (i360)	-	(£9.2m)	(£8.5m)
Long-term borrowing raised (General Fund)	-	-	(£15.0m)
Long-term borrowing raised (HRA)	-	-	-
Long-term borrowing repaid (i360)	-	-	£0.3m
Long-term borrowing repaid (General Fund)	-	-	-
Long-term borrowing repaid (HRA)	-	£3.9m	£3.0m
Short-term borrowing repaid	-	-	£1.0m
Investments made	£274.3m	£303.5m	£277.6m
Investments maturing	(£291.2m)	(£318.4m)	(£286.4m)

3.10 The following table summarises how the day-to-day cash flows in the second half-year have been funded compared to the same period in the previous year:

October to March	2013/14	2014/15	2015/16
Net cash flow (shortage)/surplus	**(£23.8m)**	**(£19.6m)**	**(£27.2m)**
Represented by:			
Increase/(reduction) in long-term borrowing	-	£5.3m	£20.2m
Increase/(reduction) in short-term borrowing*	£2.0m	-	(£1.0m)
Reduction/(increase) in investments	£16.9m	£14.9m	£8.8.m
Reduction/(increase) in bank balance	£4.9m	(£0.6m)	(£0.8m)

*South Downs National Park

Security of Investments

3.11 A summary of investments made by the in-house team and outstanding as at 31 March 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 guarantee in line with the AIS.

'AAA' rated money market funds	£7.44m	14%
'AA' rated institutions	£3.50m	6%
'A' rated institutions	£40.02m	74%
'BBB' rated institutions	£3.00m	6%
Total	**£53.96m**	**100%**
Period – less than one week	£7.44m	14%
Period – between one week and one month	£5.00m	9%
Period – between one month and three months	£8.51m	16%
Period – between three months and 1 year	£33.01m	61%
Total	**£53.96m**	**100%**

Risk

3.12 As part of the investment strategy for 2015/16 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 0.017% and 0.033% between October 2015 and March 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.

3.13 In March 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.

Compliance with the Annual Investment Strategy

3.14 During the reporting period, the information in this report provides assurance that the Annual Investment Strategy has been complied with in full.

Borrowing Strategy

3.15 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 reduce the impact of the difference in the cost of borrowing in contrast with the income received from investments, and reduce its counterparty exposure risk. The approved 2015/16 TMPS (approved by Policy & Resources on 19 March 2015) included a change in approach as a result of a number of contributing factors; an expectation of increases in interest rates next year, the expected reduction of certain reserves over the next four years, and the forward borrowing opportunities expected in the local authority market. As a result, the 2015/16 budget included provision to enter into some short-term borrowing before the first phase of forward borrowing was expected to be drawn down during 2016/17.

3.16 The forward borrowing opportunities did not become available, which coincided with historic falls and significant volatility in PWLB interest rates. Following analysis of borrowing costs and interest rate forecasts, and in consultation with the council’s Treasury Advisors, two “trigger” rates were set during the year (as reported to December 2015 within the TMPS Mid-Year Review). This allowed officers to undertake two tranches of £5.000m borrowing if the PWLB interest rates reduced to or below the two trigger rates set. This strategy was to allow the council to take advantage of dips in interest rates during this volatile period.

3.17 The first trigger rate set was met in December 2015, and the second was met in February 2016 and in both instances £5.000m of borrowing was undertaken. Interest rates dropped further still during February 2016. Further analysis of costs was carried out in consultation with the council’s Treasury Advisors and consequently, a further £5.000m tranche of borrowing was undertaken. This tranche was budgeted for in 2016/17 but brought forward to February 2016 to take advantage of these low interest rates.

3.18 A summary of the council's debt portfolio following these changes is summarised in Appendix 1.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report sets out action taken in the 6 months to March 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 this 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 3.7 to 3.9.

Finance Officer Consulted: James Hengeveld Date: 05/07/16

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).

7.3 The Council's policy and the actions outlined in the report are consistent with the Council's obligations under the Act and financial good practice.

Lawyer Consulted: Abraham Ghebre-Ghiorghis Date: 05/07/2016

Equalities, Sustainability and other significant implications:

7.4 There are no direct implications arising from this report.

SUPPORTING DOCUMENTATION

Appendices

1. A summary of the action taken in the period October 2015 to March 2016.

2. March 2016 Treasury Management Bulletin.

3. Capita's Interest Rate Forecast as at 4 July 2016

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 2015/16 approved by Policy & Resources on 19 March 2015.

3. The Annual Investment Strategy 2015/16 approved by full Council on 26 March 2015, and amended by full Council on 16 July 2015.

4. Treasury Management Policy Statement 2015/16 (including Annual Investment Strategy 2015/16) – Mid-Year Review approved by Policy & Resources Committee on 3 December 2015.

5. Papers held within Financial Services, Finance & Resources Directorate.

6. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2011.