Kirklees COUNCIL

Name and date of meeting: **Cabinet**
15 November 2016

Corporate Governance and Audit Committee
18 November 2016

Council
14 December 2016

Title of report: **Half yearly monitoring report on Treasury Management activities 2016/17**

Key Decision - Is it likely to result in spending or saving £250k or more, or to have a significant effect on two or more electoral wards?	**No**
Key Decision - Is it in the Council's Forward Plan (key decisions and private reports?)	**Key Decision: Yes** **Private Report/Private Appendix: N/A**
The Decision - Is it eligible for call in by Scrutiny?	**No**
Date signed off by Director **Is it also signed off by the Director of Resources?** **Is it also signed off by the Assistant Director (Legal Governance and Monitoring)?**	Debbie Hogg – 24 October 2016 As above Julie Muscroft – 25 October 2016
Cabinet member portfolio	**Resources**

Electoral wards affected: **N/A**
Ward councillors consulted: **N/A**
Public or Private: **Public**

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1 Purpose of report

The Council has adopted the CIPFA Code of Practice on Treasury Management. It is a requirement of the Code that regular reports be submitted to Members detailing treasury management operational activity. This report is the mid-year for 2016/17 covering the period 1 April to 30 September.

2 Summary

2.1 The report gives assurance that the Council's treasury management function is being managed on a prudent and pro-active basis. External investments averaged £44.8 million during the period at an average rate of 0.46%. Balances were invested in line with the approved strategy, where possible, in instant access accounts or short-term deposits. External borrowing has fallen to £414.7 million but is expected to rise by up to £30 million short term borrowing by the end of the year. The treasury management revenue budget is expected to underspend by £1.8 million in 2016/17. Performance is in line with the treasury management prudential indicators set for the year, but there was one material risk and compliance issue to report, when a Barclays' system failure prevented the Council from transmitting funds to other counterparty deposit accounts back in April.

3 Information required to take a decision

3.1 The treasury management strategy for 2016/17 was approved by Council on 17 February 2016. The over-riding policy continues to be one of ensuring the security of the Council's balances. The Council aims to invest externally balances of around £30 million, largely for the purpose of managing day-to-day cash flow requirements, with any remaining balances invested "internally", offsetting borrowing requirements. The investment strategy is designed to minimise risk, investments being made primarily in instant access accounts or short-term deposits, with the major British owned banks and building societies, or Money Market Funds. Diversification amongst counterparties is key. It was forecast that the Council could have an external borrowing requirement of up to £30 million.

<u>Economic Context and Interest Rates</u>

3.2 After a period of relative strong growth and stability, the outlook for the UK economy changed significantly on 23 June 2016 following the Brexit vote. The repercussions of the plunge in sentiment on economic growth were judged to be severe by the Bank of England, prompting substantial monetary policy easing, including a cut in Bank Rate in August to 0.25%, further quantitative easing and cheap funding for banks to maintain the supply of credit to the economy. After the vote, interest rates plunged to new record lows – a 50 year maturity loan from the PWLB can now be obtained at around 2.1% compared to 3.0% in April.

3.3 The effect of Brexit is expected to dampen economic growth through the second half of 2016 and in 2017. Inflation is expected to pick up due to a rise in import prices, dampening real wage growth and real investment returns. Equity markets, however, appear to have shrugged off the result of the referendum despite an initial sharp drop. The Council's treasury management advisors forecast that the Base Rate is not likely to rise within the next three years and that there is a 40% chance of a cut down to zero percent.

<u>Investment Performance</u>

3.4 The Council invested an average balance of £44.8 million externally during the period (£60.9 million in the first six months of 2015/16), generating £0.104 million in investment income. The reduction is largely due to the Government flattening the payment profiles of Revenue Support Grant.

3.5 Balances were invested in instant access accounts or short term deposits. Appendix 1 shows where investments were held at the start of April, the end of June and September by counterparty, by sector and by country.

3.6 The Council's average investment rate for the period was 0.46%. This is higher than the average for 2015/16 of 0.45%. The Base Rate cut of 0.25% at the beginning of August is gradually being factored into investment rates offered and by the end of October, all rates are expected to be around 0.25% lower.

Borrowing Performance

3.7 In terms of borrowing, long-term loans at the end September totalled £405.3 million (£408.4 million 31 March 2016) and short-term loans £9.4 million (£16.0 million 31 March 2016). There has been no new external borrowing so far this year. The external borrowing requirement for the year is still expected to be around £30 million. Any borrowing undertaken is likely to be fairly short-term, mainly to take advantage of very low borrowing rates.

3.8 In June 2016, the Council received deed polls from Barclays Bank stating that it would not exercise its options to increase interest rates on £30 million of LOBO loans held by the Council. This effectively makes the loans fixed rate maturity loans. The interest rates on these loans range from 3.81% to 4.10%. This effectively brings the total of LOBO loans down to 76.6 million which represents 18.5% of total external borrowing.

3.9 Fixed rate loans account for around 81.5% of total long-term debt giving the Council stability in its interest costs. The maturity profile for fixed rate long-term loans is shown in Appendix 2 and shows that no more than 10% of fixed rate debt is due to be repaid in any one year. This is good practice as it reduces the Council's exposure to a substantial borrowing requirement in future years when interest rates might be at a relatively high level.

3.10 The Council has occasionally borrowed small amounts from the Money Market for periods between one and two months at an average rate of 0.32%.

Revenue Budget Monitoring

3.11 The treasury management budget for 2016/17 currently stands at £32.8 million. The latest budget monitoring shows an under-spend of £1.8 million. The under-spend is due to savings on principal and interest arising from capital slippage and interest rates remaining lower for longer than expected.

Prudential Indicators

3.12 The Council is able to undertake borrowing without central government approval under a code of practice called the Prudential Code. Under this Code, certain indicators have to be set at the beginning of the financial year as part of the treasury management strategy. The purpose of the indicators is to contain the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decision impacting negatively on the Council's overall financial position. Other prudential indicators are reported as part of the monitoring of capital. Appendix 3 provides a schedule of the indicators set for treasury management and the latest position.

<u>Risk and Compliance issues</u>

3.13 On two occasions when the Council has received unexpected monies late in the day, officers have had no alternative but to put the monies into the Barclays Business Reserve Account overnight. This has led to a marginal breach of the investment limit on Barclays on each occasion. In addition at the end of April, a Barclays' software problem prevented the Council from transmitting funds to other counterparty deposit accounts. This caused the Council to have £11 million in excess of its own investment limit with Barclays over the weekend. The Council was compensated by Barclays for any loss of interest and the problem has not re-occurred.

3.14 In line with the investment strategy, the Council has not placed any direct investments with companies as defined by the Carbon Underground 200.

4 Implications for the Council

The underspending on the treasury management function has been taken into account in the consolidated budget monitoring reported to cabinet.

5 Consultees and their opinions

Arlingclose, treasury management advisors

6 Next steps

None

7 Officer recommendations and reasons

The report be received and noted by Council

8 Contact officer

Tim Mitchell Finance Manager 01484 221000

Background Papers and History of Decisions

CIPFA's Prudential Code for Capital Finance in Local Authorities.

CIPFA's Code of Practice on Treasury Management in the Public Services.

The treasury management strategy report for 2016/17 - Council 17 February 2016.

9 Assistant Director responsible

Debbie Hogg 01484 221000

APPENDIX 1

Kirklees Council Investments 2016-17											
		Credit	**1 April 2016 (opening)**			**30 June 2016**			**30 September 2016**		
Counterparty		**Rating Sept 2016***	**£m**	**Interest Rate**	**Type of Investment**	**£m**	**Interest Rate**	**Type of Investment**	**£m**	**Interest Rate**	**Type of Investment**
Specified Investments											
Bank of Scotland	Bank	F1/A+							6.0	0.40%	Instant Access
Handelsbanken	Bank	F1+/AA	2.9	0.45%	Instant Access	2.4	0.45%	Instant Access			
Std Life (Ignis)	MMF**	AAAmmf	7.5	0.49%	MMF-Instant Acc	7.5	0.53%	MMF-Instant Acc	7.5	0.37%	MMF-Instant Acc
Aviva	MMF**	Aaa-mf	7.3	0.48%	MMF-Instant Acc	6.2	0.44%	MMF-Instant Acc	8.6	0.31%	MMF-Instant Acc
Aviva - Govt	MMF**	Aaa-mf				6.3	0.37%	MMF-Instant Acc	1.5	0.17%	MMF-Instant Acc
Deutsche	MMF**	AAAmmf	6.7	0.46%	MMF-Instant Acc	8.1	0.46%	MMF-Instant Acc	6.2	0.32%	MMF-Instant Acc
Goldman Sachs	MMF**	AAAmmf	6.0	0.44%	MMF-Instant Acc	8.1	0.46%	MMF-Instant Acc	7.7	0.30%	MMF-Instant Acc
Santander UK	Bank	F1/A	5.0	0.65%	31 day notice	5.0	0.65%	31 day notice	3.0	0.40%	31 day notice
Non-specified investments											
Barclays***	Bank	F1/A	2.9	0.10%+0.40%	Instant Access	2.9	0.10%+0.40%	Instant Access	2.9	0.10%+0.40%	Instant Access
			38.3			**46.5**			**43.4**		
Sector analysis											
Bank			10.8	28%		10.3	22%		11.9	27%	
Building Society											
MMF**			27.5	72%		36.2	78%		31.5	73%	
Local Authorities/Cent Govt											
			38.3	100%		**46.5**	100%		**43.4**	100%	
Country analysis											
UK			7.9	21%		7.9	17%		11.9	27%	
Sweden			2.9	7%		2.4	5%				
MMF**			27.5	72%		36.2	78%		31.5	73%	
			38.7	100%		**46.5**	100%		**43.4**	100%	

*Fitch short/long term ratings, except Aviva MMF (Moody rating). See next page for key. The use of Fitch ratings is illustrative – the Council assesses counterparty suitability using all 3 credit rating agencies, where applicable, and other information on credit quality.

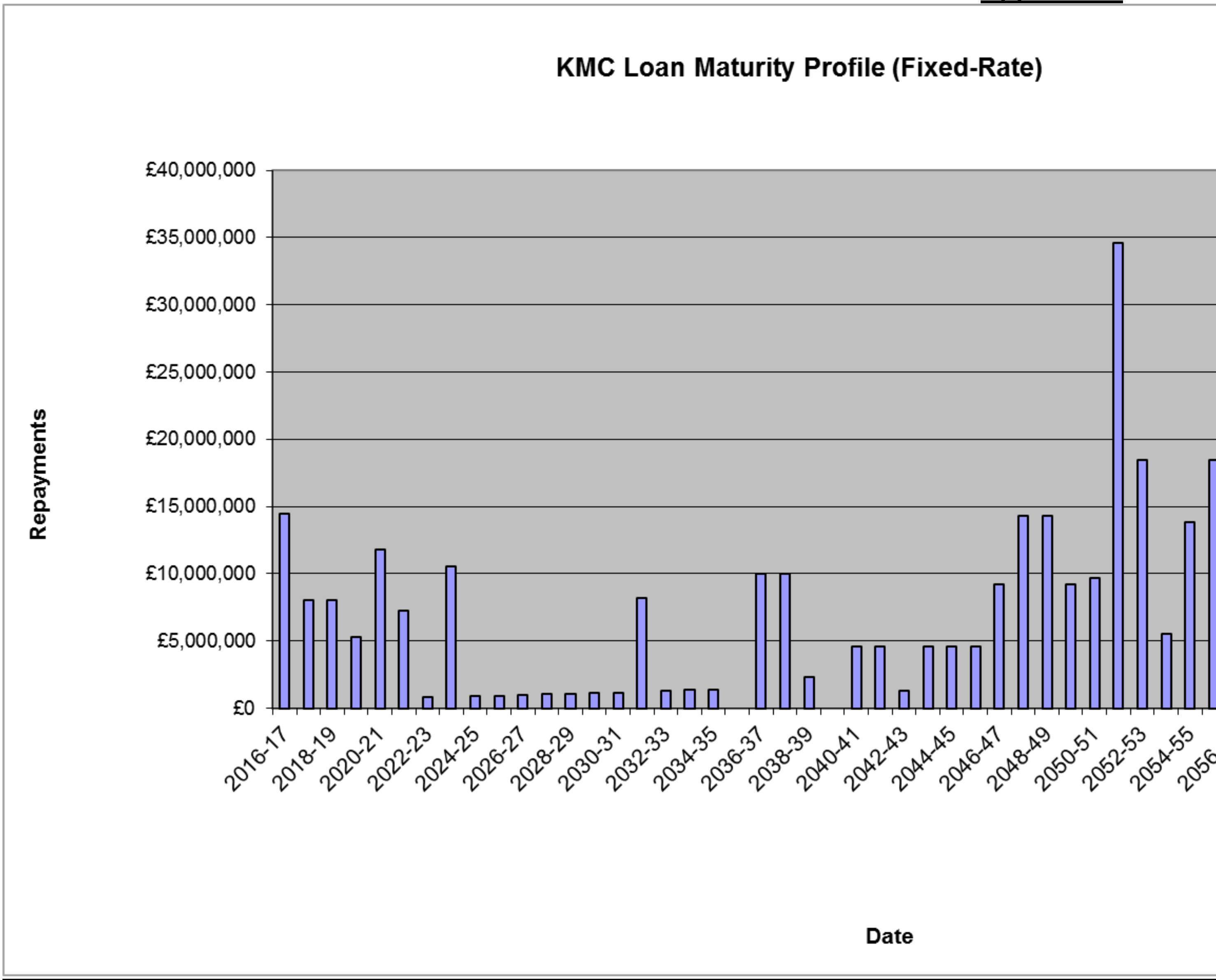
**MMF – Money Market Fund. These funds are domiciled in Ireland for tax reasons, but the funds are made up of numerous diverse investments with highly rated banks and other institutions. The credit risk is therefore spread over numerous countries, including the UK. The exception to this is the Aviva Government Liquidity Fund which invests directly in UK government securities and in short-term deposits secured on those securities.

***Barclays falls into non-specified investment category due to lower rating with S&P.

<u>Key – Fitch's credit ratings</u>:

		Long	Short
Investment Grade	Extremely Strong	AAA	
		AA+	
	Very Strong	AA	F1+
		AA-	
		A+	
	Strong	A	F1
		A-	
		BBB+	F2
	Adequate	BBB	
		BBB-	F3
Speculative Grade		BB+	
	Speculative	BB	
		BB-	
		B+	B
	Very Speculative	B	
		B-	
		CCC+	
		CCC	
	Vulnerable	CCC-	C
		CC	
		C	
	Defaulting	D	D

Appendix 2



APPENDIX 3

Treasury Management Prudential Indicators

Interest Rate Exposures

While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio. The Prudential Code requires the setting of upper limits for both variable rate and fixed interest rate exposure:

	Limit Set 2016 - 17	Estd Actual 2016 - 17
Interest at fixed rates as a percentage of net interest payments	60% - 100%	87%
Interest at variable rates as a percentage of net interest payments	0% - 40%	13%

The interest payments were within the limits set.

Maturity Structure of Borrowing

This indicator is designed to prevent the Council having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate	Limit Set 2016 - 17	Estd Actual 2016 - 17
Under 12 months	0% - 20%	2% - 4%
12 months to 2 years	0% - 20%	2% - 3%
2 years to 5 years	0% - 60%	5% - 7%
5 years to 10 years	0% - 80%	4% - 6%
More than 10 years	20% - 100%	80% - 84%

The limits on the proportion of fixed rate debt were adhered to.

Total principal sums invested for periods longer than 364 days

The Council will not invest sums for periods longer than 364 days.