Agenda Item 6.

East Northamptonshire Council

Finance Sub-Committee – 19 December 2016

Treasury Management Report to 31 October 2016

Purpose of report

The purpose of this report is to note the current position for Treasury Management for the period to 31 October 2016 in financial year 2016/17.

Attachment(s)

Appendix 1: Prudential Indicators – as at 31 October 2016/17
Appendix 2: Treasury Management Practices

1. Introduction

1.1. The Treasury Management Strategy for 2016/17 was approved as part of the Medium Term Financial Strategy (MTFS) in February 2016. It was underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009.

1.2. The CIPFA Code of Practice recommends that Members be informed of treasury management activities at least twice a year; this report therefore embraces best practice.

1.3. The report provides:

- A summary of the economic conditions affecting the council's investment strategy
- Details of investments made during the year
- A summary of the council's current investment portfolio

1.4. The council's investment priorities are:

- Security of capital invested
- Liquidity of capital invested
- Return on investment

2. Market Conditions

2.1 **Growth:** Change in gross domestic product (GDP) is the main indicator of economic growth. GDP is estimated to have grown by 0.7% in the period July to Sept 2016 compared with growth of 0.6% in the period April to June 2016. GDP was 2.3% higher in the period July to Sept 2016 compared with the same quarter a year ago.

Within Europe the fallout from the EU Referendum vote still dominates the Eurozone and will remain an uncertainty within the coming months. The European Central Bank (ECB), in its annual report, indicated that it would continue to provide further financial support beyond the current March 2017 deadline, with interest rates remaining at 0.4%.

The Federal Reserve has not changed its interest rate policy in light of the recent President election and is generally positive about the US economic outlook and job market prospects; however growth to September was higher than expected by 0.2%, inline with the revised forecast of 1.1%. This confirms the Federal Reserves forecast to increase interest rates.

2.2 **Inflation:** The Consumer Prices Index (CPI) rose by 0.5% in the year to September 2016, when compared with a 0.6% rise in the year to July, although this is still below the target of 2%. The increase in the rate between July 2016 and September 2016 takes it to the highest seen since November 2014, however, it is still relatively low in the historical context.

The official Inflation Report for August 2016 showed the Bank of England (BoE) left its forecast for growth this year unchanged at 2%, on the basis that the economy has buoyed in the three months post the EU Referendum. Indicators of activity and business sentiment have recovered from the immediate fallout of the Referendum. However, the forecast growth for 2017 saw a sharp downgrade from a previous estimate of 2.2% to 1.4% and in 2018 the growth outlook was cut to 1.7%. The BoE also revised its inflation forecasts up sharply, in light of the devaluation of sterling and its latest policy response. The BoE predicts inflation will now hit 2.75% in 2018, falling back to 2.5% by 2019.

2.3 **Monetary Policy:** The Monetary Policy Committee (MPC) voted unanimously in favour of maintaining the bank rate at 0.25% and re-enforcing its commitment to keep the Quantitative Easing (QE) programme at £435bn.

As the fallout from the EU Referendum vote has, for the time being, become slightly steady, evaporating any short term interest rate cut; the BoE indicated that interest rates are just as likely to go up as down.

2.4 **Interest Rates:** The latest forecast for interest rates, based on information from the council's Treasury Management advisors, is shown below:

Official Bank Rate	Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18
Capita	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

3. Treasury Management Activity

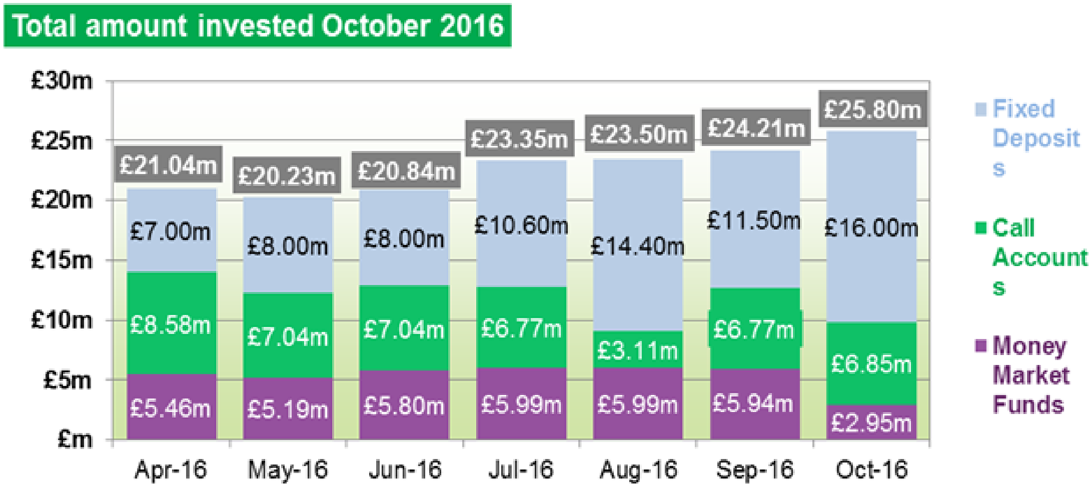
3.1. During the first four months of the 2016/17 financial year, the opportunity for the council to invest its surplus cash for periods beyond 3 to 6 months in duration has been limited. This has mainly been due to the impact of the uncertainty in the lead up to the EU Referendum vote as well as the impact following the outcome of the vote.

3.2. Investing for shorter durations reduces the counterparty risk the council is exposed to and the potential yield (interest rate) the council can achieve. However, since the impact of the EU Referendum vote and the Bank of England's decision to reduce interest rates further, any yield achievable on surplus cash balances has been and is expected to continue to be reduced. To mitigate some of the impact of reduced rates, the council opted for fixed term deposits, by investing in a 30 day notice account, which (at present) is yielding 1%, but from September onwards this was reduced to below 1%.

3.3. The council will continue to monitor the economic outlook and money markets to ensure it is able to achieve a yield in line with market expectations whilst ensuring security and liquidity of capital are maintained.

3.4. Future investment decisions are discussed between the Treasury Manager and Finance Manager and are made in line with the Annual Treasury Management Strategy approved by Council and the advice from the council's Treasury Management Advisors.

3.5. The charts below demonstrate the change in investment by type up to 31 October 2016.



3.6. Call accounts and Money Market Funds (MMF) are very short term, liquid investments. They are generally overnight deposits or short term notice accounts where the balance invested can be withdrawn immediately. Fixed Deposits are investments with a longer duration, where cash is invested for a contractually agreed period with no opportunity to withdraw cash prior to the maturity date of the deposit.

3.7. The level of cash balances held by the council has increased since April 2016 by £4.76m. An explanation is provided later in this report (see paragraph 4.4).

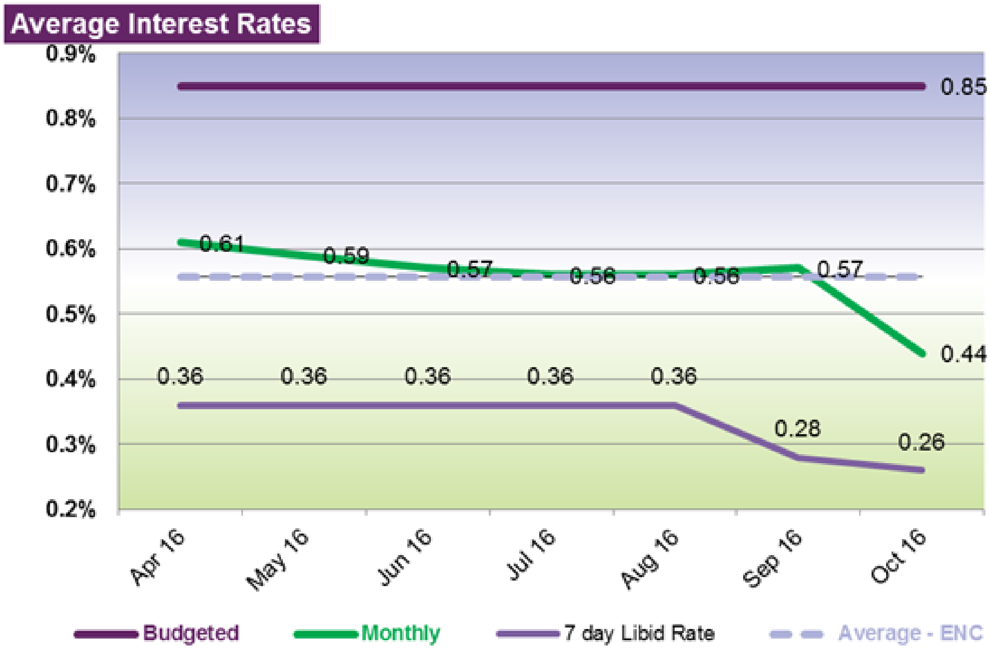
4. Treasury Management Position and Performance

4.1. The table below summarises the council's current portfolio of investments as at 31 October 2016.

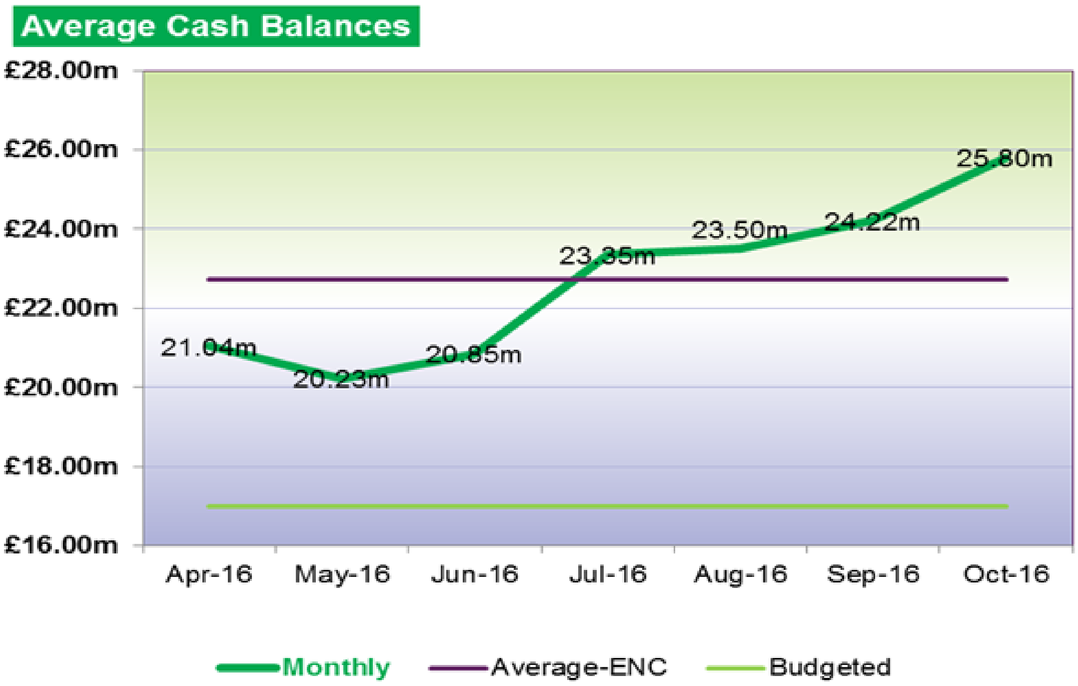
Counterparty / Lender	Amount	Rate %	Maturity Date
Call Accounts			
Santander UK (95 Day notice)	£1,500,000	0.65	
Santander UK (180 Day notice)	£1,500,000	0.90	
Close Brothers (1 month notice)	£2,987,955	0.45	
Barclays Bank Current Account	£862,296	0.05	
Money Market Funds			
Federated Sterling Liquidity Fund (Money Market Fund)	£2,950,934	0.35	
Fixed Term Deposits			
Debt Management Office (Treasury)	£3,000,000	0.15	03/11/2016
Debt Management Office (Treasury)	£1,500,000	0.15	03/11/2016
Coventry Building Society	£3,000,000	0.50	11/01/2017
Lloyds Bank	£2,000,000	0.65	25/04/2017
Lloyds Bank	£1,000,000	0.65	08/02/2017
Nationwide Building Society	£3,000,000	0.55	04/01/2017
Telford & Wrekin Council	£2,500,000	0.22	28/11/2016
	£25,801,185		

4.2. The average return on the council's portfolio to 31 October 2016 is 0.44%. This is 0.18% above the average 7-day London Interbank Bid Rate (LIBID) of 0.26%.

4.3. The council's current interest rate achievable on its investment portfolio is lower than anticipated when the budget was set in February 2016. At that time, the expected rate was 0.85%. This is demonstrated in the table below:



4.4. Whilst the council's investments are achieving lower rates of return, the level of cash balances held by the council is higher than anticipated when the budget was set in February 2016, as demonstrated in the table below. The majority of the increase in cash balances is due to the timing of Council Tax and Business Rates receipts and slippage within the Capital Expenditure Programme.



4.5. During 2015/16, the higher level of cash balances resulted in a higher amount of interest earned for the council. However, for 2016/17, due to the downturn in interest rates, the interest receivable is expected to be below budget by approximately £39.5k.

4.6. The council continues to make use of its surplus monies, meaning there has been no requirement to undertake any external borrowing. Consequently, no interest payable has been incurred during this period.

4.7. The overall Treasury Management outturn is set out below.

Treasury Management Budget vs. Estimated Outturn				
	Budget £	Estimated Outturn £	Pressure £	
Investments	£144,500	£105,040	(£39,460)	Lower interest rates being achieved, partly offset by higher than expected cash balances
Total	**£144,500**	**£105,040**	**(£39,460)**	

5. Prudential Indicators

5.1. Prudential Indicators look at the council's capital expenditure in terms of affordability and sustainability over the medium term and in particular the impact of these capital investment decisions on Council Tax. Details of each of the prudential indicators are shown in **Appendix 1.**

5.2. A key indicator for the council is the Ratio of Financing Costs to Net Revenue Stream. As the council has no external borrowing, the indicator for affordability is zero which is line with what was estimated. Further detail on this indicator can be seen in appendix 1 (paragraph 1).

5.3. Another key indicator for the council is the Incremental Impact of Capital Investment Decisions on cash surpluses. This shows the impact of the capital investment in terms of the potential increase in the Council Tax funding requirement, i.e the opportunity costs (interest receivable) of not being able to invest these surplus funds elsewhere. During 2016/17 the council has decreased its investment within the capital programme and therefore the impact on Council Tax has decreased. Additionally, the interest rate foregone is lower than budgeted at 0.44% compared to 0.85%. The reduction in interest rates has allowed the council to ensure its capital expenditure remains affordable and sustainable. Further detail can be found in Appendix 1 (paragraph 3).

	2016/17 Estimate	2016/17 Actual
Capital Expenditure	£1,773,005	£1,715,322
Increase in Band D Council Tax	0.50p	0.33p

6. Treasury Management Practices (TMPs)

6.1. During 2016 the Council's constitution was updated with items being amended and consolidated. The TMPs were removed from this document, but are required to be incorporated into the Treasury Management Strategy.

6.2. The TMPs will be included within the Treasury Management Strategy for 2017/18. In advance of this an example of the TMP's which the Council may wish to adopt within the strategy is attached at Appendix 2.

7. Equality and Diversity Implications

7.1. This report is for information. There are no equality and diversity implications arising from the content.

8. Legal Implications

8.1. This report is for information. There are no legal implications arising from the content.

9. Risk Management

9.1. This risks arising from Treasury Management activity are recorded in the Risk Register. The risks are subject to regular review and update.

10. Financial Implications

10.1. This report is for information, there are no financial implications arising from this report.

11. Corporate Outcomes

- ***Good Value for Money***
  This report demonstrates that the council is ensuring it effectively manages its surplus cash to achieve good value for money for the Council
- ***Effective Management***
  Treasury Management allows the council to manage its surplus cash balances to ensure the main principles (Security, Liquidity, and Yield) are maintained, contributing to effective management of the council

12. Recommendations

12.1. Finance Sub-Committee is recommended to:

a) note the Treasury Management performance for period 7 of 2016/17;

b) note the Treasury Management Practices (Appendix 2) for inclusion in the Treasury Management Strategy from 2017/18

(Reason – in accordance with CIPFA guidance and best practice in Treasury Management)

<table>
<tr><td rowspan="2">Legal</td><td colspan="5">Power: Local Government Finance Act 2002</td></tr>
<tr><td colspan="5">Other considerations:</td></tr>
<tr><td colspan="6">Background Papers:</td></tr>
<tr><td colspan="6">Person Originating Report: Michelle Drewery, Finance Manager, 01832 742267
mdrewery@east-northamptonshire.gov.uk</td></tr>
<tr><td colspan="6">Date: 29/11/2016</td></tr>
<tr><td>CFO</td><td></td><td>MO
8/12/16</td><td>S Matthews</td><td>CX
8/12/16</td><td>D. Oliver</td></tr>
</table>

Appendix 1

Prudential Indicators – as at 31 October 2016

1. 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 borrowing costs. The definition of financing costs is set in the Prudential Code.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Estimate %	2016/17 Estimate (Revised) %
General Fund	0.00	0.00
Total	**0.00**	**0.00**

As the council has no external borrowing the indicator is zero, in line with what was estimated.

2. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	2016/17 Estimate £m	2016/17 Estimate (Revised) £m
General Fund Capital Programme	0	0
Embedded Lease (Refuse Contract)	389	330
Total CFR	**389**	**330**

The council's underlying need to borrow for the main capital expenditure activity is nil. The embedded lease element is due to the accounting treatment (required by the Code of Practice) of the underlying assets held by Kier in delivering the refuse contract on behalf of the council.

3. Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax.

Incremental Impact of Capital Investment Decisions	2016-17 Estimate £	2016-17 Estimate (Revised) £
Increase in Band D Council Tax	0.50	0.33

This shows the impact of the capital investment in terms of potential increase in the Council Tax funding requirement, i.e. the opportunity costs (interest receivable) of not being able to investment these surplus funds.

4. Authorised Limit and Operational Boundary for External Debt

The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).

The **Operational Boundary** links directly to the council's estimates of the CFR and estimates of other cashflow requirements

Authorised Limit for External Debt	2015/16 Approved £'000
Borrowing	2,000
Other Long-term Liabilities	450
Total	**2,450**
Operational Boundary for External Debt	
Borrowing	0
Other Long-term Liabilities	450
Total	**450**

In the unlikely event that the council would be required to borrow within the Authorised Limit and Operational Boundary, it could only be for short term rather than a long term capital investment plan.

5. Summary

The council is maintaining an affordable and sustainable capital programme in the medium term.

The council does not currently have any external debt and has not breached either the operational or authorised limits as set out in the 2016/17 Treasury Strategy.

Please see below an example of the Treasury Management Practices which will be incorporated into the Treasury Management Strategy for 2017/18.

In compliance with Treasury Management Practices (TMP) 1 to 12, the Council has arrangements in place as follows:

TMP 1 - Treasury Management Policy 1

In addition to managing risks in relation to investment timing, interest rates and counterparties as set out above, the Council manages the following risks:

Inflation - The Council will be aware of prevailing levels of inflation and take action where necessary to protect its finances.

Refinancing – The Council will ensure that its borrowing and financing arrangements are negotiated and structured in a manner which are favourable to the Council that can be reasonably achieved in the light of the market conditions prevailing at the time.

Legal and Regulatory - The Council places temporary surplus funds through the services of brokers on the London Money Market. Four brokers are currently used and are listed in the Council’s Treasury Management policy. The role of the brokers is outlined in the Bank of England’s Non Investment Products Code (NIPs), which the Council complies with. The code is detailed on the Bank of England’s Website. All money transactions with brokers to approved banks, building societies and local authorities are evidenced with confirmations from both brokers and borrowers. All payments to institutions are approved by a Senior Officer and documented.

Fraud, error and corruption, and contingency management - Details of systems used and procedures to be followed are held on file. These details will include procedures required in the event of an emergency through system failure. Arrangements are in place for when the designated member of treasury management is absent so sufficient cover is available. Consideration has been given to treasury management in the Council’s Corporate Disaster Plan. All personnel responsible for the Treasury Management function are included in the Authorities Insurance Policy.

Market Risk Management - The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect it from the effects of such fluctuations.

TMP 2 – Best Value and Performance Measurement

The Council measures its treasury management activities through analysis of the actual interest received on our total investments, cumulative interest earned and average rate received and actual interest versus budgeted interest.

At the beginning of each financial year, a budget will be formulated for the expected interest earned based following assumptions regarding the Bank of England Base Rate, market forces, Treasury Advisory Information and other national statistics.

The Council will aim to benchmark against other Local Authorities performance and other managed funds. Information regarding markets and interest rates from the brokers will be considered.

TMP 3 – Decision-making and analysis

The Council will be clear about the nature and extent of the risks it may become exposed to. The Chief Finance Officer will inform Members where risks are material and will significantly impact on the Council's Finances.

The Council will record and retain adequate documentation in relation to the basis of decision making and the transactions undertaken. Competitiveness will be ensured by obtaining market rates daily from each of our approved brokers prior to placing the funds with an approved counterparty.

TMP 4 – Approved instruments, methods and techniques

Aside from the statutory or regulatory constraints, the council is not limited as to what instruments, methods or techniques it may use in managing its treasury management affairs, as long as they consistent with risk management as outlined in TMP 1.

TMP 5 – Organisation, clarity and segregation of responsibilities, and dealing Arrangements

Finance Sub Committee and Policy and Resources Committee will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Chief Finance Officer, and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Council's policy statement and Treasury Management Practices and CIPFA's Standard of Professional Practice on Treasury Management.

Segregation of Responsibilities. - The officers responsible for Treasury management operations are the Financial Services Manager and the Accountant (Treasury Management). All transactions are approved separately by two other senior officers. The control accounts for the treasury management function are independently reconciled.

TMP 6 – Reporting requirements and management information arrangements
As a minimum, Policy and Resources Committee will receive an annual report on the strategy and plan for the forthcoming financial year and a quarterly treasury management activity report is taken to Finance Sub Committee.

TMP 7 – Budgeting, accounting and audit arrangements

The Council will prepare and approve an annual budget for treasury management. Performance of actual interest earned will be measured against budgeted interest expected for the financial year.

TMP 8 – Cash and cash flow management

Cash flow projections will be prepared on a regular and timely basis. The Council as a minimum will prepare cash flow forecasts and actuals to be able to determine the optimum arrangements to be made for investing and managing surplus cash, to assess whether minimum acceptable levels of cash balances plus short term investments might be breached and the adequacy of standby/overdraft facilities or other contingency arrangements.

TMP 9 – Money Laundering

The Council will not tolerate fraud and corruption in the administration of its responsibilities, whether from inside or outside the Council. It's expectation of propriety and accountability is that Members and staff at all levels will lead by example in ensuring adherence to legal requirements, rules, procedures and practices. As a minimum the Council will adopt the practice to serve as a reminder for staff to remain vigilant given that money laundering represents a growing threat. The Monitoring Officer, in consultation with the Chief Finance Officer, will develop and maintain an anti-fraud and corruption policy. All suspected irregularities and financial impropriety must be reported to the Chief Finance Officer, who will report to Internal Audit, the Chief Executive and Monitoring Officer. The Council will also review how anti-money laundering regulations impact on the authority.

TMP 10 – Staff training and qualifications

The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. The Council will seek to employ suitably qualified staff for its Treasury Management function. The Council will continue to invest in training its treasury management staff to enable them to keep up with new developments and new Treasury Management practices.

TMP 11 – Use of External Service Providers

The Council has appointed Capita Asset Services, Treasury Solutions to assist it in making optimum investments and borrowing decisions based on up-to-date data.

The Council also uses the services of a total of four brokers for the purpose of placing surplus cash investments and refinancing of borrowing (if any). This ensures the authority does not have an over-reliance on one or a small number of brokers. The brokers provide interest rates and market economy information. The four brokers currently used are Sterling International, Tullet Prebon, RP Martin and Tradition. The council does not currently employ an external fund manager to supplement in house skills and resources, but the authority will consider these services should they add value to current operations.

TMP 12 – Corporate Governance

East Northamptonshire Council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

East Northamptonshire Council has adopted and has implemented the key recommendation of the Code. This is considered vital to the achievement of proper corporate governance in treasury management, and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.