

By: John Simmonds, Cabinet Member for Finance
Andy Wood, Corporate Director of Finance

To: Governance and Audit Committee – 25 January 2018

Subject: **TREASURY MANAGEMENT 6 MONTH REVIEW 2017-18**

Classification: Unrestricted

Summary: To present the Treasury Management 6 Month Review

FOR DECISION

INTRODUCTION

1. This report covers Treasury Management activity for the 6 months to 30 September 2017 and developments in the period since up to the date of this report.
2. If agreed by members this 6 month report will then go on to Council.
3. The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report therefore ensures this council is embracing Best Practice in accordance with CIPFA's recommendations.
4. The Council's Treasury Management Strategy for 2017-18 was approved by full Council on 9 February 2017.
5. The Council has both borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

EXTERNAL CONTEXT

6. The dominant issues for financial markets in the 6 months to the end of September were the election of a minority Conservative government in June as well as rising inflation. The Consumer Price Inflation (CPI) rose to 3% at the end of September and further to 3.1% by the end of November, as companies passed on the higher costs stemming from the lower level of sterling. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates from 0.25% to 0.5% in November 2017.
7. The FTSE 100 has risen reaching a record high in December of 7,688. Money markets rates remained low in the period to the end of September. 1-month, 3-month and 12-month LIBID rates averaged 0.25%, 0.30% and 0.65% respectively, rising after the increase in the bank rate.

REGULATORY UPDATES

Implementation of the Markets in Financial Instruments Derivative (MiFID II)

8. Under the current UK regime, KCC is automatically categorised as a 'per se professional' client in respect of both MiFID and non-MiFID scope business. However following the introduction of MiFID II from 3 January 2018, this will change and KCC must be classified as a "retail client" but can be opted-up by financial services firms to "elective professional client" status providing it meets certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians.
9. The Council has elected to opt up as it meets the criteria; holding an investment balance of at least £10 million with the persons authorised to make investment decisions on behalf of the authority having at least one year's relevant professional experience. It is also able to assure these firms that these persons have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

CIPFA Consultation on Prudential and Treasury Management Codes

10. CIPFA published the two revised codes in late December 2017 for implementation in 2018/19. Changes to the Prudential Code include the requirement for a new Capital Strategy report and changes to prudential indicators. Changes to the Treasury Management Code include non-treasury investments such as commercial investments in property being included in the definition of "investments".

DCLG Consultation on Proposed Changes to Investment and Minimum Revenue Provision (MRP) Guidance

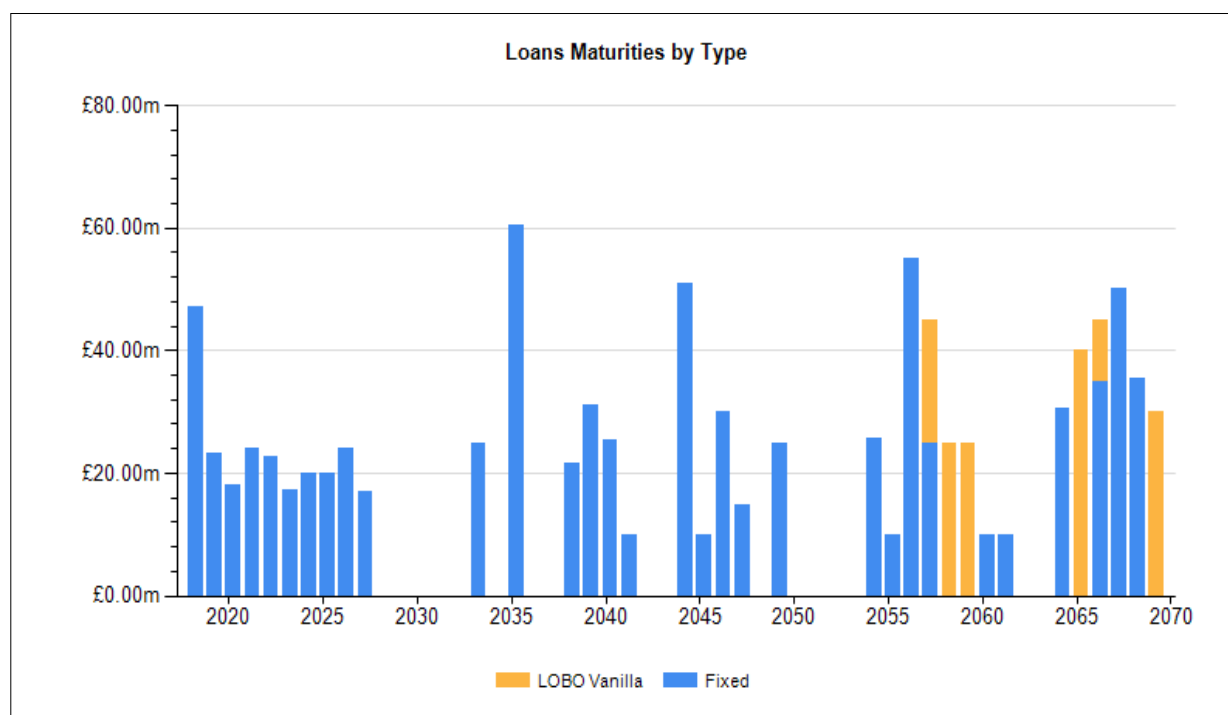
11. In November DCLG launched its consultation with responses due by 22 December 2017. The intention is that these changes come into force for the 2018/19 financial year.
12. Proposed changes to the investment guidance include widening the definition of investments to include all financial assets as well as non-financial assets held for the primary purpose of generating income including investment properties and loans. The guidance also covers the issues of security and liquidity of investments as well as more detailed risk assessment.
13. The new guidance on MRP includes an updated definition of MRP provision and guidance on asset lives but does not propose changes to the methods of calculation.

BORROWING STRATEGY

14. At 30 November 2017 the Council had total debt outstanding of £980.75m, an increase of £15.25m from the balance as at 31 March 2017. The following table shows the borrowing analysed by lender.

	31/3/2017 Balance £m	2017-18 Movement £m	30/11/2017 Balance £m	Weighted Average Rate %	Weighted Average Life (yrs)
Public Works Loan Board	504.3	-6.02	498.28	5.68%	16.59
Banks (LOBO)	160.0	-10.00	150.00	4.03%	44.54
Banks (Fixed Term)	301.2	11.28	312.48	4.17%	38.36
	965.5	-4.75	960.75	4.93%	28.04
Temp borrowing – local authority		20.00	20.00	0.31%	0.19
Total borrowing	965.5	15.25	980.75	4.83%	27.46

15. The maturity profile of KCC's outstanding debt is as follows:



16. Total external debt managed by KCC includes £35.91m pre-LGR debt managed by KCC on behalf of Medway Council and £0.57m for other bodies.
17. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

18. The benefits of internal borrowing are monitored regularly against the potential for incurring additional costs and the Council's Treasury Advisor, Arlingclose has assisted it with this 'cost of carry' and breakeven analysis. The Council's strategy has enabled it to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
19. KCC continues to hold LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The total value of these loans fell to £150m at the end of August as the result of RBS' decision to waive its options on a £10m loan agreed in December 2009, converting it into a fixed rate loan and assigning it to Phoenix Life Assurance Ltd.
20. Since the start of the current financial year the Council has received a further £4.53m of the funding agreed for the County's street lighting and expects to receive a total of £10.8m in 2017-18. KCC also expects to repay £32m of maturity and EIP PWLB loans by 31 March 2018

INVESTMENT ACTIVITY

Counterparty Update

21. The impact on KCC's counterparties and investments of the uncertain economic environment is being carefully monitored by officers and the Council's treasury advisors. Arlingclose's credit advice remains cautious however duration limits for major UK banks and building societies were unchanged with Standard Chartered remaining suspended from the list.

Investment activity 2017-18

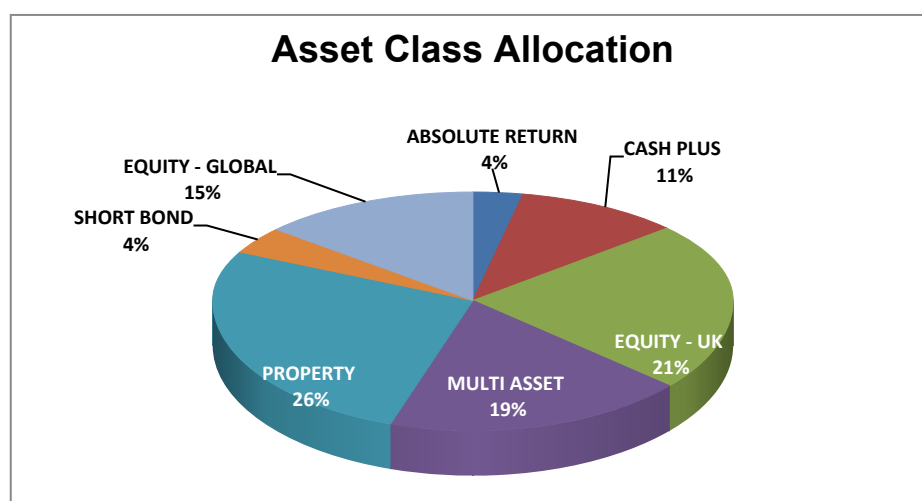
22. The Council holds significant invested funds representing income received in advance of expenditure plus balances and reserves held. Cashflow forecast indicated that during 2017-18 investment balances would range between £254m and £378m.
23. Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
24. Security of capital has remained the Council's main investment objective. Against a background of increasing uncertainty and given the increasing risk of bail-in and falling returns from short-term unsecured bank investments, the Council has continued to diversify into more secure and/or higher yielding asset classes as set out in its Treasury Management Strategy Statement for 2017-18. During

August and September 2017 the Council moved £55m from bank deposits into pooled investment funds including the CCLA Property Fund.

25. As at the end of November the types of investment held were as follows:

Type of Investment	Total	
	£m	%
Notice Account	25.00	8.34
Money Market Fund	49.80	16.61
Fixed Deposit	10.00	3.34
Covered Bond	76.10	25.39
Icelandic Recoveries Outstanding	0.37	0.12
Internally managed cash	161.27	53.80
Pooled Investment Funds	116.26	38.80
Cashplus / Short Term Bond Funds	20.05	6.69
Externally managed cash	136.31	45.49
Equity	2.14	0.71
Total	299.72	100.00

26. A breakdown of the external investments by asset class is as follows



27. A detailed schedule of KCC's investments as at 30 November 2017 is attached in Appendix 1. This schedule is circulated to members of the Treasury Management Advisory Group every Friday.

ICELANDIC DEPOSITS

28. In June the Icelandic authorities lifted exchange controls and KCC took the opportunity to sell 706.2m ISK held in escrow accounts in Iceland being funds received as a result of the repayment of deposits originally made with Glitnir and Landsbanki banks. KCC received EUR5.1m from the sale and in July sold the Euros realising £4.6m. These funds were used for the investment in the CCLA fund.

29. As at October 2008 KCC had deposits (principal and interest) totalling £51.99m outstanding with Icelandic Banks. The total amount recovered by KCC now totals £52.6m, some £600k higher than the original claim. £372k remains outstanding from Heritable bank and settlement of this claim is subject to the resolution of a dispute concerning a property portfolio.

FORECAST OUTTURN

30. The average cash balances were £305.3m in the half year representing income received in advance of expenditure plus balances and reserves held. New internally managed investments over the 6-month period were made at an average rate of 0.65%.

COMPLIANCE WITH PRUDENTIAL INDICATORS

31. The Council can confirm that it has complied with its Prudential Indicators for 2017-18 set as part of the Council's Treasury management Strategy Statement. Details can be found in Appendix 2.

TREASURY ADVISOR

32. The council continues to use the treasury advisory services of Arlingclose who were reappointed for a 3 year period from 1 August 2016.

RECOMMENDATION

33. Members are asked to endorse this report and recommend that it is submitted to Council.

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Investments as at 30 November 2017

1. Internally Managed Investments

1.1 Term deposits, Call accounts and Money Market Funds

Instrument Type	Counterparty	Principal Amount	Interest Rate	End Date
Fixed Deposit	Lloyds Bank	£5,000,000	0.90%	08/02/2018
Fixed Deposit	Close Brothers	£5,000,000	0.50%	08/02/2018
180 Day Call Notice Account	Santander UK	£25,000,000	0.90%	n/a
Total UK Bank Deposits		£35,000,000		

Money Market Fund	Aberdeen Sterling Liquidity Fund	£2,803,188	0.42% (variable)	n/a
Money Market Fund	Deutsche Managed Sterling Fund	£11,902	0.23% (variable)	n/a
Money Market Fund	Federated (PR) Short-term GBP Prime Fund	£9,973,335	0.50% (variable)	n/a
Money Market Fund	HSBC Global Liquidity Fund	£597,431	0.22% (variable)	n/a
Money Market Fund	Insight Liquidity Funds PLC	£6,465,287	0.28% (variable)	n/a
Money Market Fund	LGIM Sterling Liquidity Fund	£9,990,557	0.33% (variable)	n/a
Money Market Fund	SSgA GBP Liquidity Fund	£9,981,846	0.31% (variable)	n/a
Money Market Fund	Standard Life Sterling Liquidity Fund	£9,972,827	0.51% (variable)	n/a
Total Money Market Funds		£49,796,373		
Equity and Loan Notes	Kent PFI (Holdings) Ltd	£2,135,741		n/a
Icelandic Recoveries outstanding	Heritable Bank Ltd	£366,905		n/a

1.2 Bond Portfolio

Bond Type	Issuer	Adjusted Principal	Coupon Rate	Maturity Date
Fixed Rate Covered Bond	Bank Of Nova Scotia	£4,987,436	0.88%	14/09/2021
Floating Rate Covered Bond	Barclays	£5,000,380	0.69%	12/02/2018
Floating Rate Covered Bond	Barclays	£2,399,151	0.86%	12/02/2018
Fixed Rate Covered Bond	Coventry Building Society	£3,079,278	1.93%	19/04/2018
Fixed Rate Covered Bond	Coventry Building Society	£5,142,465	1.73%	19/04/2018
Fixed Rate Covered Bond	Coventry Building Society	£2,061,088	1.52%	19/04/2018
Floating Rate Covered Bond	Coventry Building Society	£3,005,179	0.56%	17/03/2020
Fixed Rate Covered Bond	Leeds Building Society	£5,771,641	0.63%	17/12/2018
Fixed Rate Covered Bond	Leeds Building Society	£2,085,960	2.03%	17/12/2018
Fixed Rate Covered Bond	Leeds Building Society	£1,558,096	1.19%	17/12/2018
Floating Rate Covered Bond	Leeds Building Society	£5,000,000	0.74%	01/10/2019
Floating Rate Covered Bond	Leeds Building Society	£2,500,311	0.75%	09/02/2018
Floating Rate Covered Bond	Leeds Building Society	£2,500,316	0.75%	09/02/2018

Appendix 1

Floating Rate Covered Bond	Lloyds	£3,900,291	0.55%	19/01/2018
Floating Rate Covered Bond	Lloyds - Bonds	£1,402,406	0.58%	18/07/2019
Fixed Rate Covered Bond	National Australia Bank	£3,002,504	1.10%	10/11/2021
Floating Rate Covered Bond	Nationwide Building Society	£2,149,096	0.71%	27/04/2018
Floating Rate Covered Bond	Nationwide Building Society	£3,428,506	0.60%	27/04/2018
Fixed Rate Covered Bond	Santander UK	£3,528,063	0.65%	14/04/2021
Floating Rate Covered Bond	Santander UK	£3,000,808	0.69%	29/05/2018
Floating Rate Covered Bond	Toronto-Dominion Bank	£5,453,658	0.95%	01/02/2019
Fixed Rate Covered Bond	Yorkshire Building Society	£3,094,680	1.55%	12/04/2018
Fixed Rate Covered Bond	Yorkshire Building Society	£2,054,403	1.98%	12/04/2018
Total Bonds		£76,105,717		.

Total Internally managed investments	£163,404,736
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2. Externally Managed Investments

Investment Fund / Equity		Market Value at 30 November 2017	12 months return to 30 November 2017	
Fund Name	Asset Class		Income	Total
CCLA LAMIT Property Fund	Property	£35,357,498	4.22%	5.71%
Pyrford Global Total Return Fund	Absolute Return	£5,006,220	10.12%	2.34%
Fidelity Multi Asset Income Fund	Multi Asset	£25,476,754	3.89%	5.56%
Schroders Income Maximiser Fund	Equity – UK	£19,889,137	3.22%	0.45%
M&G Global Dividend Fund	Equity Global	£10,298,197	0.62%	3.57%
Threadneedle Global Equity Income Fund	Equity – Global	£10,175,827	0.81%	1.57%
Threadneedle UK Equity Income Fund	Equity – UK	£10,056,999	1.12%	-1.20%
Aberdeen Ultra Short Duration Sterling Fund	Cash Plus	£10,062,395	0.00%	0.54%
Payden & Rygel Sterling Reserve Fund	Short Bond	£4,994,389	0.32%	0.21%
Royal London Cash Plus Fund	Cash Plus	£4,996,110	0..30%	0.22%
Total External Investments		£136,313,527		

3. Total Investments

Total Investments	£299,718,262
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2017-18 October Monitoring of Prudential Indicators

1. Estimate of capital expenditure (excluding PFI)

Actuals 2016-17	£238.519m
Original estimate 2017-18	£261.303m
Revised estimate 2017-18	£247.603m

2. Estimate of capital financing requirement (underlying need to borrow for a capital purpose)

	2016-17	2017-18	2017-18	2018-19	2019-20
	Actual	Original Estimate	Forecast as at 31.10.17	Forecast as at 31.10.17	Forecast as at 31.10.17
	£m	£m	£m	£m	£m
Capital Financing requirement	1,362.394	1,369.445	1,335.182	1,326.041	1,289.365
Annual increase/reduction in underlying need to borrow	14.135	-2.182	-27.212	-9.141	-36.676

In the light of current commitments and planned expenditure, forecast net borrowing by the Council will not exceed the Capital Financing Requirement.

3. Estimate of ratio of financing costs to net revenue stream

Actuals 2016-17	13.41%
Original estimate 2017-18	13.18%
Revised estimate 2017-18	13.07%

4. Operational Boundary for External Debt

Appendix 2

The operational boundary for debt is determined having regard to actual levels of debt, borrowing anticipated in the capital plan, the requirements of treasury strategy and prudent requirements in relation to day to day cash flow management. The operational boundary for debt will not be exceeded in 2017-18

(a) Operational boundary for debt relating to KCC assets and activities

	Prudential Indicator	Position as at 31.10.17
	£m	£m
Borrowing	980	945
Other Long Term Liabilities	245	245
	<u>1,225</u>	<u>1,190</u>

(b) Operational boundary for total debt managed by KCC including that relating to Medway Council etc (pre Local Government Reorganisation)

	Prudential Indicator	Position as at 31.10.17
	£m	£m
Borrowing	1,018	981
Other Long Term Liabilities	245	245
	<u>1,263</u>	<u>1,226</u>

5. Authorised Limit for External debt

The authorised limit includes additional allowance, over and above the operational boundary to provide for unusual cash movements. It is a statutory limit set and revised by the Council. The revised limits for 2017-18 are:

	Authorised limit for debt relating to KCC assets and activities	Position as at 31.10.17	Authorised limit for total debt managed by KCC	Position as at 31.10.17
	£m	£m	£m	£m
Borrowing	1,020	945	1,058	981
Other long term liabilities	245	245	245	245
	<u>1,265</u>	<u>1,190</u>	<u>1,303</u>	<u>1,226</u>

6. Compliance with CIPFA Code of Practice for Treasury Management in the Public Services

Appendix 2

The Council has adopted the Code of Practice on Treasury Management and has adopted a Treasury Management Policy Statement. Compliance has been tested and validated by our independent professional treasury advisers.

7. Upper limits of fixed interest rate and variable rate exposures

The Council has determined the following upper limits for 2017-18

Fixed interest rate exposure	100%
Variable rate exposure	50%

These limits have been complied with in 2017-18.

8. Upper limits for maturity structure of borrowings

	Upper limit	Lower limit	As at 31.10.17
	%	%	%
Upper 12 months	10	0	4.59
12 months and within 24 months	10	0	1.84
24 months and within 5 years	15	0	7.36
5 years and within 10 years	15	0	10.65
10 years and within 20 years	20	5	8.72
20 years and within 30 years	25	5	19.76
30 years and within 40 years	25	10	16.39
40 years and within 50 years	30	10	24.01
50 years and within 60 years	30	10	6.68

9. Upper limit for principal sums invested for periods longer than 364 days

Indicator	£260.0m
Actual	£198.7m