HERTFORDSHIRE COUNTY COUNCIL

AUDIT COMMITTEE
FRIDAY 1 DECEMBER 2017 AT 10.00 AM

Agenda Item No:
5

MID-YEAR REPORT ON THE TREASURY MANAGEMENT SERVICE AND PRUDENTIAL INDICATORS 2017/18

Report of the Chief Finance Officer

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Executive Member: David Williams, Deputy Leader of the Council

1. Purpose of Report

1.1. The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and CIPFA Code of Practice for Treasury Management in the Public Sector require the Council to set an annual Treasury Management Strategy (TMS) and assess performance indicators and the treasury function throughout the year.

1.2. This report fulfils the requirement to provide a mid-year report on performance against the prudential indicators which were specified in the Integrated Plan, Part D approved by the County Council on 21 February 2017.

1.3. The report provides a summary of treasury management performance and activity for the period to 30 September 2017.

2. Summary

2.1. The Council has been compliant with the prudential and treasury management indicators set out in the Integrated Plan.

2.2. A breach of the TMS occurred on Thursday 4 May 2017 as a result of the methodology used to record overnight changes in balance on a Barclays Call Account. This did not result in any loss to the authority and actions to mitigate any future occurrence have already been taken. Section 5 provides further details of the breach and procedural changes implemented as a result.

2.3. UK economic growth has remained positive but subdued during the period, with significant uncertainty remaining as to the impact of the nation's withdrawal from the European Union which is currently being negotiated. Further economic analysis is provided in section 6.

2.4. The Council has continued to operate a diverse investment portfolio. Pooled fund investments are held for the long-term due to capital volatility. Daily liquidity needs are met using a variety of instant-access bank and Money Market instruments, along with short term lending to and from other local authorities.

2.5. A distribution of £37k was received in respect of the Icelandic Investment with Kaupthing Singer & Friedlander Limited [KSF]. No further funds have been received for the investment with Heritable. The recovery to date from these two investments stands at 84.25% and 98.00% and respectively.

2.6. No new long-term borrowing has been taken and no long-term borrowing has been repaid in the year.

2.7. Short-term borrowing of £30m was in place at the start of the year, and an additional £10m of short-term borrowing was made during the first quarter to cover cash flow requirements. All short-term borrowing was repaid by 30 September.

2.8. Treasury management activities will be impacted by a number of changes to the regulatory environment between January 2018 and January 2019. These changes are set out in section 11, with further details provided in Appendix B to this report.

3. Recommendations

3.1. Members are invited to note the Treasury Management mid-year report.

4. Background

4.1. The Council operates its treasury management function in accordance with the CIPFA Prudential Code and the CIPFA Code of Practice for Treasury Management in the Public Sector. The Codes require the Council to set prudential indicators for its capital expenditure and treasury management activities prior to the start of each financial year.

4.2. The Codes also require that regular reports are provided reviewing performance and compliance at the end of each financial year and on a half-yearly basis. In addition to these reports, performance against the prudential indicators and treasury management activities are reported to Cabinet as part of the quarterly budget monitoring report.

5. Breach of Strategy (4 May 2017)

5.1. The breach arose as the methodology being used to record overnight changes in balance on the Barclays account on the Treasury Management System did not trigger a control warning when the exposure limit was breached. As a result a balance of £10.275m was held in the account overnight, breaching the limit of £10m in place for this counterparty. The balance was correctly reduced the following day.

5.2. Procedures for recording overnight balance changes have been revised so that an alert is correctly triggered if balances are recorded in excess of the limits set in the system. All treasury officers have been instructed in the revised data entry method to avoid breaching counterparty limits. No financial loss was incurred as a result of this breach.

6. Economic Review

6.1. The Council's Treasury management activities in this period were undertaken in an environment of continued uncertainty and negative market sentiment which has prevailed since the EU membership referendum in June 2016 and subsequent triggering of Article 50 by the UK Government on 29 March 2017.

6.2. The Bank of England base rate has remained stable at 0.25% during the period, and economic data showed subdued growth in Gross Domestic Product [GDP], at 0.2% and 0.3% in the first and second quarters respectively. During the same period Consumer Price Index [CPI] inflation rose to 3.0%, above the 2% Bank of England target, while wage growth was 2.1% in August 2017.

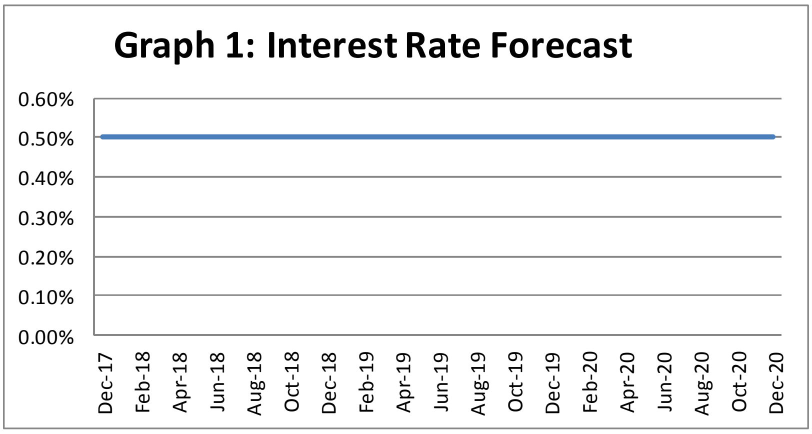
6.3. The Bank of England had looked to business investment and exports to sustain GDP, while consumer spending remains vital for growth. Negative real-terms wage growth coupled with falling household savings may constrain economic activity during the remaining months of the calendar year.

6.4. The inflationary pressures noted above are an expected consequence of the approximately 20% decline in the value of Sterling during 2016/17. Despite an expectation that the Bank of England would look through short-term peaks in inflation resulting from currency fluctuation and maintain support for the economy through continued low interest rates and asset purchases, the rhetoric of Monetary Policy Committee (MPC) members changed during the autumn to imply a forthcoming increase in bank rates.

6.5. The expectation of a rate rise fuelled slight increases in gilt yields and short-term investment rates towards the end of the second quarter, although returns remain subdued overall.

6.6. On 2 November 2017, the MPC met and voted 7-2 in favour of increasing the bank rate from 0.25% to 0.50%, in line with market expectations.

6.7. Graph 1 (overleaf) provides the Arlingclose (the Council's treasury adviser) interest rate forecast for the period December 2017 to December 2020.



6.8. There is an expectation that in the context of a struggling economy and Brexit-related uncertainty, the Bank of England is likely to take a measured approach to monetary tightening, with any increase to interest rates being gradual and limited in order that substantial economic support is provided during the Brexit transition.

6.9. Whilst the Bank has indicated the possibility of two further rate increases in the next two to three years, the Council's advisers believe that this is predicated on optimistic assumptions about the Brexit settlement and ongoing economic growth and currently see little prospect of further rate increases.

7. Prudential and Treasury Management Indictors

7.1. The Prudential Code requires the Council to set and monitor a range of prudential indicators relating to borrowing. The objectives of the Prudential Code are to ensure, within a clear framework, that capital investment plans for local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

7.2. The Council measures and manages its exposure to treasury management risks using a range of indicators related to interest rate exposure, refinancing risk and liquidity risk. In addition, treasury activity is measured against a range of performance indicators related to security, liquidity and yield.

7.3. Appendix A provides evidence of compliance with the prudential and treasury management indicators and reports on treasury activity performance indicators.

8. Treasury Management Strategy

8.1. In setting the 2017/18 TMS, the Council approved a Lending Policy that continued to enable flexibility in use of investment instruments whilst maintaining security and liquidity of investments.

8.2. The Lending Policy continued to reflect the on-going risks in the wider economy and banking institutions. The primary considerations when placing investments continues to be the security and liquidity of the Council's funds and only once both of these factors have been taken into account will the yield on investment be considered. Long term borrowing is only considered when it becomes necessary to avoid a prolonged short term overdraft position.

8.3. During the six months to 30 September 2017, investments have been held in a range of instruments detailed in Table 1

Table 1: Counterparties and investment instruments used To 30 September 2017

Counterparty	Investment Instruments
Local Authorities	Fixed Term
UK Banks / Building Society	Call / Notice Accounts
Overseas Banks with AA+ Sovereign Rating	Call Accounts, Fixed Bonds
AAA rated Money Market Funds	Call / Notice
Pooled Fund – Property	Notice
Pooled Fund – Bond	Notice
Pooled Fund – Equity	Notice
Pooled Fund – Multi-asset	Notice

8.4. Table 2 provides a summary of the value of investment instruments outstanding as at 31 March 2017 and 30 September 2017 and the percentage of investment instruments compared to the overall investment portfolio.

8.5. Table 2 (Overleaf) reflects the diversified investment portfolio being operated by the council within the bounds of the TMS.

Table 2: Investment Activity as at 31 March 2017 and 30 September 2017

Counterparties	Investment Instrument	As at 31/3/2017		As at 30/9/2017	
		£m	%	£m	%
Local Authorities	Fixed Term	5.00	4.9	20.00	16.5
UK Banks / Building Society	Call / Notice	15.68	15.4	19.81	16.4
Overseas Banks	Call	0.00	0.0	0.00	0.0
	Fixed Bond	3.02	3.0	0.00	0.0
Money Market Funds	Call / Notice	47.88	47.1	51.08	42.3
Pooled Fund – Property	Notice	10.00	9.9	10.00	8.3
Pooled Fund – Bond	Notice	10.00	9.9	10.00	8.3
Pooled Fund – Equity	Notice	6.00	5.9	6.00	4.9
Pooled Fund – Multi-asset	Notice	4.00	3.9	4.00	3.31
TOTAL		**101.52**	**100.0**	**120.89**	**100.0**

8.6. Cash balances increased by a net £16.74m during the period, and £30m of temporary borrowing held at 31 March 2017 was repaid. The overall £46.74m increase in cash balances between 31 March and 30 September was due to timing differences between receipts and payments, including £33m of Single Local Growth Fund funding awarded to the LEP and held within the Council's balances, but not yet spent. Interest earned on LEP balances is apportioned to the LEP at year end.

8.7. Table 3 shows the value and type of maturities and new investments made during the first half of the year:

Table 3: Value of Maturities and New Investments
1 April – 30 September 2017

Period	Instrument Type	Maturities	Investments
		£m	£m
Quarter 1	Fixed Deposit – Other Authority	(5.00)	0.00
	95 Day Notice Account	(10.00)	0.00
	Fixed Bond	(3.02)	0.00
	31 Day Notice Account	0.00	10.00
	Fixed Deposits (Other Authority	0.00	15.00
	Quarter 1 Total	**(18.02)**	**25.00**
Quarter 2	Fixed Deposit – Other Authority	0.00	5.00
	Quarter 2 Total	0.00	**5.00**
	2017-18 Total	**(18.02)**	**30.00**

8.8. A total of £30m continues to be invested over the long term in a number of diversified pooled funds. The pooled funds have experienced some variations in capital value during the year. This variability is expected as the nature of these types of investments in bond, equity and multi-asset funds means that income yield and fund values are influenced by market movements. It is important to recognise the long-term nature of these investments in mitigating this expected volatility. The changes in market value are fluid depending on market conditions and are therefore not recognised as gains or losses in the financial statements.

8.9. At 30 September 2017, the net market value of the Pooled Fund investments was approximately £30.74m. This represents an increase of approximately £188k on the valuation at 31 March 2017. Appendix A, Section 3 provides more details of how the Council intends to utilise and balance these instruments alongside its existing investments with regards to management of security, liquidity and yield.

8.10. Interest rates for investments have ranged between 0.27% and 0.55% for fixed durations of up to 364 days. Interest rates on variable investments have ranged between 0.15% for Call Account investments and 0.22% for Money Market Fund Investments. These rates reflect the historically low 0.25% Bank of England base rate introduced to provide economic support following the EU referendum result in 2016.

8.11. Table 4 provides a summary of the treasury activity in the period April 2017 to September 2017.

Table 4: Treasury Activity - 1 April 2017 to 30 September 2017

Measure	April 2017 to September 2017
Average size of portfolio (excluding Iceland investments)	£131.23m
Weighted average term (fixed term only)	45 days
Annual Equivalent Average rate earned	1.40%
Interest earned	£0.918m

8.12. The annualised total rate of return for the first six months was 1.40%, which represents a reduction on the average return of 1.58% achieved in 2016/17. Whilst the pooled funds have performed well, returning an annual equivalent of 4.86%, short term balances were exposed to poor prevailing market rates resulting in the reduction in overall return.

8.13. The annualised rate of return for the first half of the year (1.40%) includes underlying returns of 0.32% for the investment portfolio excluding the pooled fund investments. The 0.32% rate compares to 0.46% achieved in the 2016/17 financial year and exceeds the 7-day LIBID benchmark of 0.11% by 0.21%.

8.14. The total interest forecast on treasury investments for the year is £1.713m, which exceeds the budget of £1.434m, contributing an underspend of £279k.

8.15. Investments returns have exceeded budgeted expectations due to a number of factors. Cash balances across the first six months have been higher than originally forecast. Officers were able to lend some of this surplus cash to other local authorities for fixed terms of between one and six months, which yielded better returns than those paid by very short-term liquid investments. The Pooled Funds have performed strongly and are delivering returns exceeding the 4% target level.

8.16. All treasury management activity undertaken during the period complied with the approved treasury management strategy, the CIPFA Code of Practice for Treasury Management and the relevant legislative provisions.

9. Icelandic deposits

9.1. Of the original four Icelandic banks in which the County Council had deposits, the outstanding Landsbanki claim was sold in 2013/14 resulting in a total recovery of 92%. The outstanding Glitnir claim was resolved in February 2015 resulting in a total recovery of 101% of the amounts originally deposited.

9.2. As of 30 September 2017 repayments for the investments in Heritable total 98.0p in the £. The Administrators, Ernst and Young (EY), are not forecasting any additional distribution to creditors. The claim cannot be closed as a reserve has been retained to cover administrator costs and expenses until outstanding legal matters are resolved.

9.3. During February 2017 EY announced an additional repayment of 0.50p in the £ for the investments in Kaupthing, Singer & Friedlander [KSF]. This was paid in May 2017. Recovery as at 30 September stood at 84.25p in the £. EY estimate that the total return will be between 85.5 to 86.5p in the £.

9.4. Table 5 provides details of dividends received to 30 September 2017 together with current information about the anticipated value and percentage recovery for Icelandic investments.

Table 5: Icelandic bank deposits at 30 September 2017
ALL Claims

Bank	Original Deposit	Recovered at 30/9/2017	Total expected distribution		Claim Status
	£m	£m	£m	%	
Glitnir	7.00	7.05	7.05	100.71	Closed
Landsbanki	10.00	9.23	9.23	92.30	Closed
Heritable Bank	7.00	6.88	6.88	98.29	Open
KSF	4.00	3.49	3.53	88.25	Open
TOTAL	**28.00**	**26.65**	**26.69**	**95.32**	

10. Borrowing

Long Term Borrowing

10.1. Table 6 shows total long term borrowing outstanding at 30 September 2017, the future maturity profile of borrowing and an analysis of sources of borrowing shown as a percentage of the total.

Table 6: Borrowing maturity profile at 30 September 2017

	Total	Sources of Borrowing[1]					
		PWLB		LOBO		Commercial	
	£m	£m	%	£m	%	£m	%
Borrowing at 30 September 2016	258.78	103.28	39.9	49.40	19.1	106.10	41.0
Maturing in 2016/17	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maturing in 2017/18	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maturing later	258.78	103.28	39.9	49.40	19.1	106.10	41.0
Average interest rate	4.61%		5.36%		4.37%		4.43%

10.2. At 30 September there was a total of £258.78m long term borrowing outstanding. £103.28m (40%) was sourced from the government's Public Works Loan Board (PWLB)[1] and £155.50 (60%) was sourced from commercial banks.

10.3. The average rate of interest for total borrowing was 4.61%, the average rate for PWLB borrowing was 5.36% and the average rate for borrowing from commercial banks was 4.41%.

10.4. The long term borrowing portfolio is kept under review in consultation with the Council's treasury advisor Arlingclose to identify opportunities to reduce borrowing costs by restructuring existing loans. The current low interest rates mean that there would be a significant premium[2] payable to restructure the existing borrowing.

10.5. The difference between planned capital expenditure and capital funding (from revenue or capital receipts and specific capital grants) is known as the Capital Financing Requirement (CFR), and is met via borrowing. Borrowing can be

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[1] PWLB = Borrowing sourced from the government's Public Works Loans Board
LOBO = Borrowing sourced from commercial banks
Commercial = Fixed rate loans from commercial banks

[2] Redemption Premium: The early repayment of loans is subject to a premium or discount calculation. This reflects the difference between current market rates and the loan rate. If the market rate is lower than the loan rate, the lender would earn less interest on a new loan than it does on the redeemed loan. A premium on repayment is charged which reflects the difference between the current value of the interest on the original loan and that on a new loan. Thus the lender is compensated for the loss of interest.

funded from externally sourced loans, for example from the Public Works Loans Board, or internally from the council's own resources.

10.6. Because the cost of long term borrowing remains significantly higher than the return on short-term investments, the Council has made prudent use of its resources to fund an element of its borrowing requirement from surplus cash balances held in respect of its reserves. This has allowed the Council to maintain a lower level of external borrowing, which has in turn minimised the pressure on the revenue budget from interest payments.

<u>Short Term Borrowing</u>

10.7. Short term borrowing was required on multiple occasions during the first half of the year, due to differences in timing between receipts and associated payments. Maximum short term borrowing during the period was £40m.

10.8. Borrowing was sourced either through direct deals with counterparties such as banks and other local authorities, or through external brokers who act as an intermediary between borrowers and lenders. Borrowing rates varied from 0.44% to 0.15% (including brokerage fees of between 0.03% - 0.10%) for durations of 7 to 122 days.

10.9. All temporary loans had been repaid by 30 September 2017.

11. Forthcoming Regulatory Changes

11.1. A number of changes in the regulatory environment will occur in the next six to 18 months, as per table opposite:

Title	Timing	Impact / Status
Markets in Financial Instruments Regulations (MiFID II)	Effective date: 3 January 2018	Significant compliance administration to mitigate potential portfolio and cost impacts. Work In Progress.
Bank Ring-Fencing	Deadline April 2019	Work in Progress
Prudential and Treasury Code Review	Effective date: 1 April 2018	Amended reporting and disclosure requirements. May require adoption of transitional arrangements. Awaiting final code publication (expected by End December 2017)
Money Market Fund Regulation	Implementation Deadline: 21 January 2019	Awaiting confirmation of Funds' plans. Expected to be minimal operational impact but subject to review when fund intentions are known.
Minimum Revenue Provision [MRP] & Investment Guidance (DCLG)	Consultation expected: November 2017	DCLG intends to consult on amendments to its MRP and investment guidance to ensure it is fit for purpose and to provides for appropriate governance around commercial investments

11.2. For a full description of the impacts and work being carried out by treasury officers to prepare for these changes please see Appendix B.

12. Hertfordshire Police and Crime Commissioner – Treasury Management

12.1. The Police and Crime Commissioner (PCC) contracts with Hertfordshire County Council to deliver its Treasury Management services.

12.2. A separate treasury management strategy is maintained for the PCC. Data concerning the Police's cash flow is provided to the Council's treasury officers and any surplus cash flow is invested in accordance with the investment criteria outlined in the PCC's Treasury Management Strategy. The Police's cash flow and investment portfolio is maintained separately from the Council's funds.

12.3. The reporting arrangements for the PCC are similar to the Council's. An annual treasury management strategy is prepared before the start of each financial year, with mid-year and end-year reports subsequently delivered on treasury management activities and delivery of the strategy. Quarterly reports are also provided according to the schedule of meeting dates provided by the PCC.

APPENDIX A: PRUDENTIAL INDICATORS 2017/18 – 30 September 2017

1. Capital financing Indicators

	Indicator	Description	Integrated Plan Ref.	2017/18 IP	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	Indicators 1 to 3 demonstrate the affordability and sustainability of the capital programme. The projections for financial years 2017/18 to 2018/19 are set out in the Integrated Plan at the reference shown in the table below.							
1	**Capital Expenditure** Monitors capital expenditure for 2017/18 against the projections set out in the Integrated Plan		2.4 Table 1	£219.29m	£192.40m	£174.7m		
2	**Capital Financing Requirement (CFR)** Monitors the Council's underlying need to borrow for capital purposes for 2017/18 against the projections set out in the Integrated Plan		2.10 Table 3	£580.44m	£577.80m	£564.81m		
3	**Ratio of financing costs to net revenue stream** Monitors the percentage of revenue budget set aside to service capital financing costs (borrowing costs net of lending income) for 2017/18 against projections set out in the Integrated Plan.		2.11 Table 4	1.47%	1.37%	1.35%		

	Indicator	Description	Integrated Plan Ref.	2017/18 IP	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	Treasury Position: **The Treasury Management Prudential Indicators are set to contain lending and borrowing activities within approved limits. The indicators are set at a level that will provide enough flexibility for effective treasury management whilst managing the risk of a negative impact on the Council's overall financial position in the event of adverse movements in interest rates or borrowing decisions. The indicators are also used to demonstrate that Net Borrowing does not exceed the Capital Financing Requirement. The projections for financial years 2014/15 to 2017/18 are set out in the Integrated Plan.**							
4A	**Net Borrowing**	Monitors actual borrowing less actual lending	NA	NA	£151.08m	£137.89m		
4B	**Net Borrowing Less than CFR**	Comparison of net borrowing to CFR	NA	NA	✓	✓		
	Borrowing: Indicators 5 and 6 control the overall level of borrowing. The limits for 2017/18 to 2017/18 are set out in the Integrated Plan.							
5	**Authorised Limit *(against maximum position)***	Monitors the borrowing limit for 2017/18 beyond which borrowing is prohibited without Member approval.	6.5 Table 11	£495m (LIMIT)	£495m	£495m		
6	**Operational Boundary**	Monitors the estimated external debt for the financial year 2017/18. This is not a limit and actual borrowing can vary. This estimate acts as an indicator to ensure the authorised limit is not breached.	6.5 Table 11	£465m (LIMIT)	£465m	£465m		

2. Treasury Management Indicators

	Indicator	Description	Integrated Plan Ref.	2017/18 Budget	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	Interest Rate Exposure: **Indicators 7 and 8 limit the Council's exposure to both fixed and variable interest rate movements.** **The limits for 2017/18 to 2017/18 are set out in the Integrated Plan.**							
7	**Upper limit on fixed interest rates *(against maximum position)***	Monitors the limits set for 2017/18 for the volume and value of the (lending) /borrowing portfolios that may be committed for fixed interest rate investments or borrowing	6.7 Table 12	£325.00m (LIMIT)	£258.78m	£258.78m		
8	**Upper limits on variable interest rates *(against maximum position)***	Monitors the net limits set for 2017/18 for the volume and value of the (lending) /borrowing portfolios that may be committed for variable interest rate investments or borrowing	6.7 Table 12	£97.50m (LIMIT)	(£107.70m)	(£120.89m)		
	Maturity structure of fixed rate borrowing (against maximum position): **Indicator 9 limits the Council's exposure to large fixed rate sums falling due for refinancing in the same period.** **The indicators are set relatively high to give the council enough flexibility to respond to opportunities to repay or reschedule debt during the financial year, while remaining within the parameters set by the indicators.**							
9A	Under 12 months		6.8 Table 13	50%	0.00%	0.00%		
9B	12 months to 2 years		6.8 Table 13	50%	0.00%	0.10%		
9C	2 years to 5 years		6.8 Table 13	60%	1.22%	1.12%		
9D	5 years to 10 years		6.8 Table 13	80%	3.28%	3.28%		

	Indicator	Description	Integrated Plan Ref.	2017/18 Budget	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
9E	10 years to 20 years		6.8 Table 13	85%	7.92%	7.92%		
9F	20 years to 30 years		6.8 Table 13	90%	12.34%	12.34%		
9G	30 years and above		6.8 Table 13	100%	75.24%	75.24%		
	Investments greater than 364 days (against maximum limit): **Indicator 10 measures the Council's exposure to investing for periods greater than one year.** **This indicator is required to ensure that the Council is aware of the cashflow implications for long term investments.** **This includes deposits at risk in Icelandic Banks.**							
10	Investments greater than 364 days (Maximum Limit)*		6.9 Table 14	£50m	£30.63m	£30.63m		

*Includes Pooled Fund investments, which can be withdrawn in less than one year but the intention is to hold for the long-term to minimise the risk of capital value volatility, as agreed at Full Council on the 25th November 2014.

3. Treasury Management Performance and Activity Measures

	Indicator	Description	Integrated Plan Ref.	2017/18 Q1	2017/18 Q2	2017/18 Q3	2017/18 Q4
	The CIPFA Treasury Management Code of Practice requires the Council to set performance indicators to assess the treasury function. Group A measures performance for "Security, Liquidity and Yield" and Group B measures the performance of "Operational Activities"						
	GROUP A: Security, Liquidity and Yield						
	Average Investment Portfolio Monitors the average amount HCC has had invested in third parties.		7.3 Table 16	£133.47m	£129.02m		
	Average borrowing portfolio Monitors the average amount HCC has as long term borrowing during the quarter		6.3 Table 10	£258.78m	£258.78m		
	Security Indicator: Average Credit Rating of Investments held Measured on a 1 to 10 scale, where 1 is a very good Credit Rating, i.e., government guaranteed and 10 is BBB-, or unrated but Investment Grade.		Section 6.10	4.46	4.72		
	Liquidity Indicator: Weighted Average Maturity of investments held Measures the liquidity/accessibility of investments in average days		Section 6.10	23 days	14 days		
	Yield Indicator: Interest Earned* Monitors the interest earned on HCC investments. Shown as both an actual amount and a percentage of amount invested		7.3 Table 16	1.35% £0.451m	1.45% £0.467m		
	Yield Indicator: Interest Paid Monitors the interest paid on HCC borrowing. Shown as both an actual amount and a percentage of amount borrowed		7.2 Table 15	4.35% £3.13m	4.74% £3.10m		

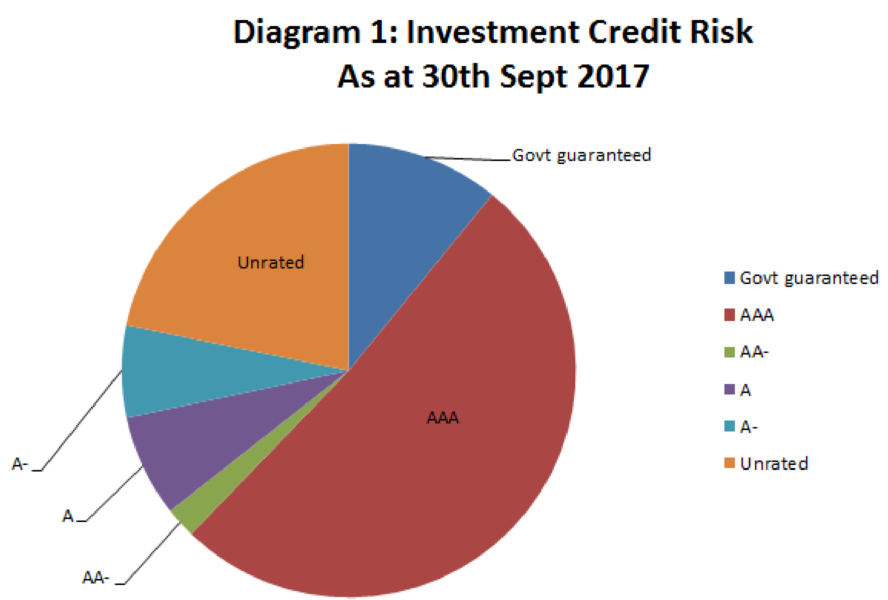
*includes Pooled Fund investments, see Yield section below for further information for rate excluding Pooled Funds

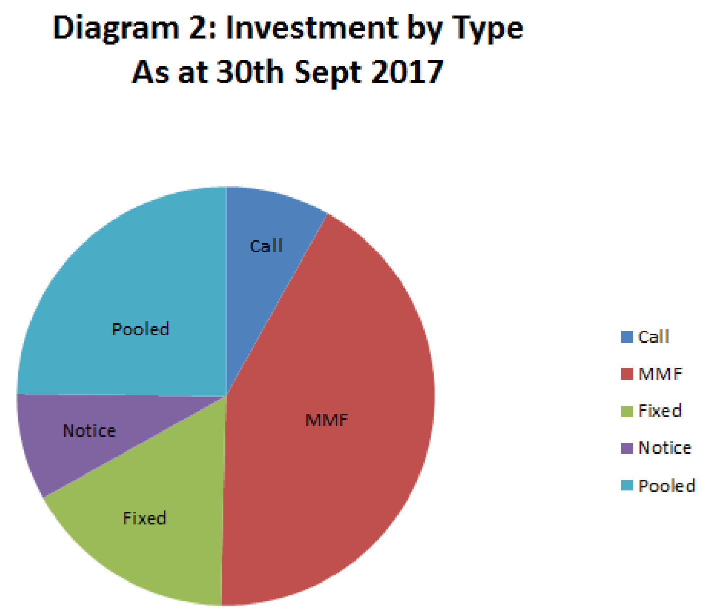
Security, Liquidity and Yield

Security - Exposure to Risk

The Treasury Management Strategy was approved on 21st February 2017 as Part D of the Integrated Plan. This maintained the range of investment types approved for use in 2016/17. The approved instruments were last changed in 2014/15 to enable greater diversification of the investment portfolio; these changes introduced greater flexibility in use of investment instruments whilst continuing to maintain security and liquidity of investments.

The following diagrams illustrate the credit rating breakdown of all investment instruments by credit rating grade and investment type for the Council's investment portfolio as at 30th September 2017





Investment Portfolio and Activity

The greater proportion of the investment portfolio is held in highly liquid money market funds and call accounts. This reflects the need to ensure adequate liquidity in the management of cash balances to meet daily cashflow requirements.

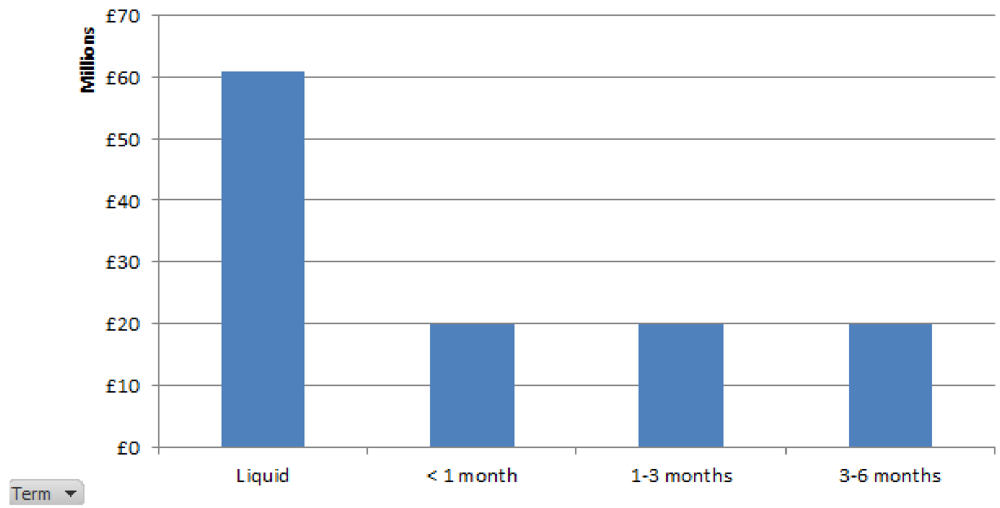
Investments in pooled funds consist of the CCLA Property Fund, two bond funds, two multi-asset funds and one equity fund.
One new fixed term deposit was made during the period. This is with Salford City Council for four months.
A fixed term loan to Worthing Borough Council, and a Svenska Handelsbanken bond matured during the period

Liquidity

Investment balances are forecast to reduce during the second half of 2017/18, which has restricted opportunities to make new fixed-term investments. Diagram 3 (overleaf) provides a graph showing the liquidity of the Council's investments portfolio as at 30th September 2017.

The potential capital volatility of the pooled fund investments means that they are intended to be held for 3-5 years, but in the graph below these investments are shown on the basis of their accessibility. These funds are all classified as "liquid", except the Property Fund which is accessible on 30 day notice.

Diagram 3: Investment Portfolio Liquidity Profile
As at 30th Sept 2017

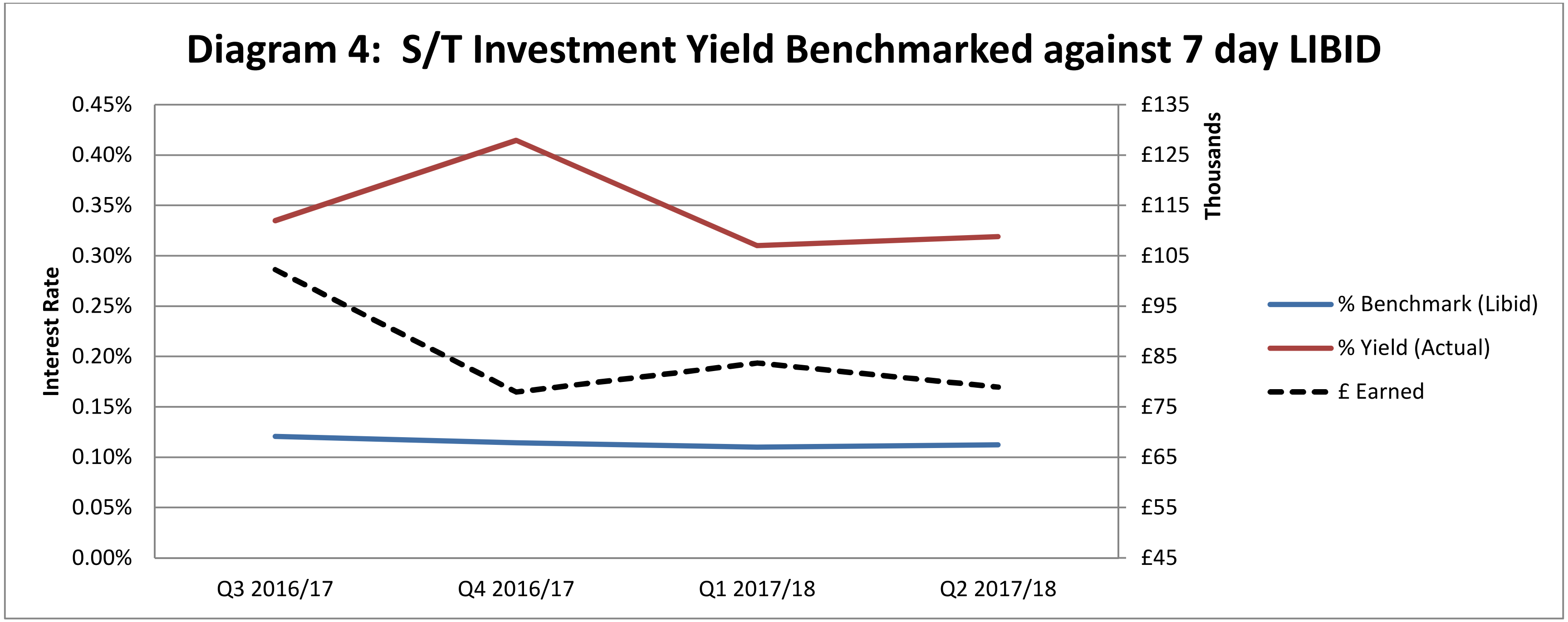


Yield

Yield: Short-Term Investments

The benchmark used for assessing the performance of return on short-term lending is the 7-Day London Interbank Bid Rate (LIBID). Diagram 4 shows yield against the benchmark for the last four quarters (solid lines, right-hand axis) and the actual cash earned (dashed line, right-hand axis).

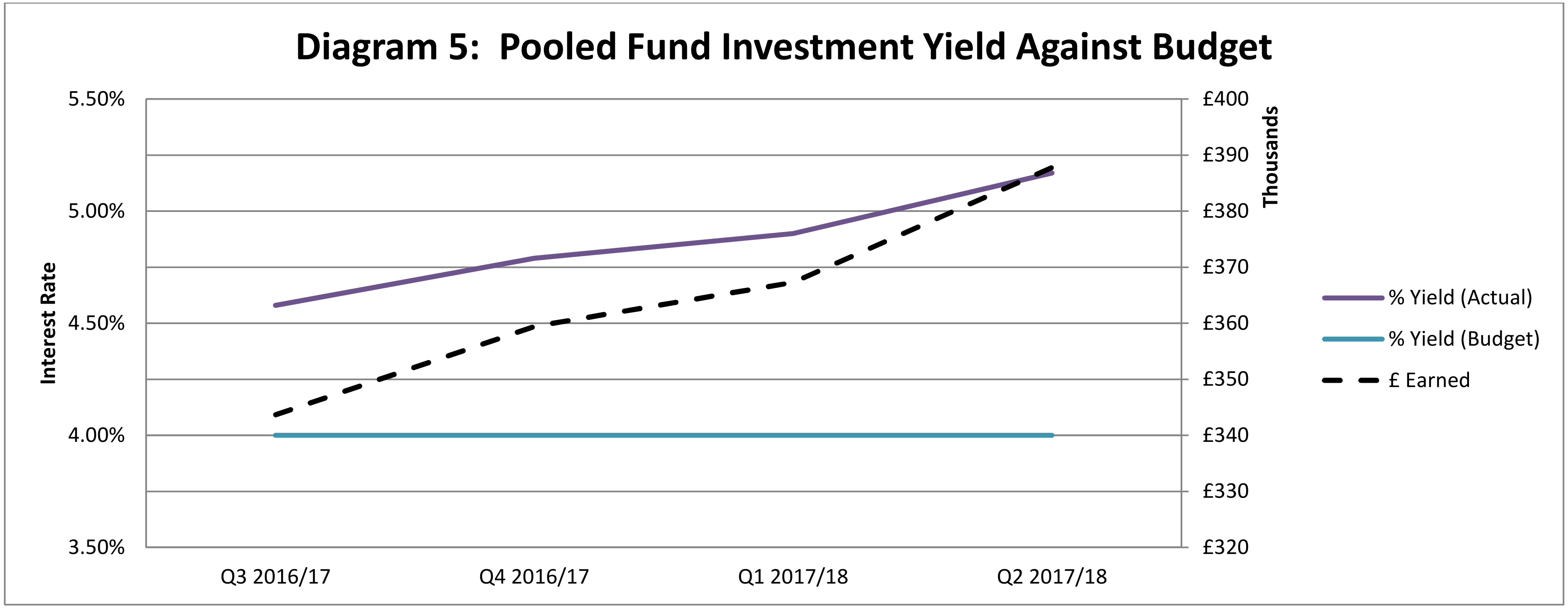
LIBID remained constant at 0.11% during the first half of the year, remaining stable despite significant uncertainty in financial markets. The return excluding pooled fund interest increased from 0.31% to 0.32%. This additional fixed-term lending during the second quarter which improved % yield despite lower average balances.



Yield: Pooled Funds

The performance of the Council's strategic investments is benchmarked against the target yield level of 4.00%, which forms the basis of the income budget. Diagram 5 shows yield against budget for the last four quarters (sold lines, left-hand axis) and the actual cash earned (dashed line, right-hand axis).

The Pooled funds have consistently achieved returns exceeding expectations, and the average % yield during 2017/18 is equivalent to 4.86% per annum.



APPENDIX B: Forthcoming Regulatory Changes

There are a number of changes to the regulatory environment which are planned for implementation in the coming months. The following provides an overview of the changes, the timescales for implementation, and the expected impacts on HCC treasury activity.

1. Markets in Financial Instruments Directive (MiFID II) Regulation Effective Date: 3 January 2018

1.1. MiFID II is a package of EU regulation which is being applied locally by the UK's Financial Conduct Authority (FCA). It is part of a rolling programme of reforms which have been developed following the 2007/8 financial crisis, and is principally concerned with the classification and protection of investors, and the investment products which are considered appropriate for these bodies/persons.

1.2. Currently (under MiFID I) the Council is considered by default to be a 'professional' client, and it has the option to 'opt-down' to 'retail' status. The MiFID II Regulation changes the default status to retail with an option to 'opt-up' to professional status, subject to meeting certain criteria.

1.3. The criteria to opt up to professional status under MiFID II include having an investment balance of at least £10m, having regular exposure/activity within a particular investment market, and an evaluation of the knowledge and experience of the officers who make investment decisions to ensure they understand the risks involved in making investment decisions and dealing.

1.4. The regulation is intended to ensure organisations have expertise, experience and knowledge to make certain investment decisions and understand the risks involved with various financial products. The main additional protection afforded to retail clients is a duty on the firm to ensure that the investment is 'suitable' for the client.

1.5. The impact on HCC of a retail designation would likely be an increase in costs, and restrictions on access to products that the authority currently uses to deliver its treasury strategy and maintain a diversified portfolio. These include Treasury Advice, Pooled Funds including Money Market Funds and brokers who arrange lending on the inter-authority market.

1.6. MiFID II Retail investor status does not equate to the status of a retail bank depositor. As such retail status does not afford the Council any additional substantive protection, such as those given to individuals under the Financial Services Compensation Scheme.

1.7. We believe the Council meets the conditions to opt up to professional status and we will provide evidence to our market counterparties in order to maintain the current MiFID status. This process is underway and officers are engaging with counterparties through a number of channels.

1.8. Treasury officers are considering if there is a requirement to opt up to professional status for retail-eligible products if doing so will avoid paying additional product fees.

2. Bank Ring-Fencing

2.1. Banking regulations have been changed to require banks which have interests in both retail and investment banking activities to ring-fence retail activities in a separate entity.

2.2. The intent behind this regulation is to protect retail investors from the impact of losses made by a bank's riskier investment banking activities.

2.3. The Council's bank, Barclays, has confirmed that it will ring-fence its activities into two new entities under the same parent company. These will be known as Barclays Plc and Barclays UK (the ringfenced retail bank).

2.4. The Council's accounts will in future sit within Barclays Plc. The main impact of the change is that whilst the council's account numbers will not change, the sort code attached to those accounts will.

2.5. This is a potentially significant change, and Barclays have appointed a dedicated Migration Manager to work through the issues related to the change, required actions to manage the change, and officers are working to finalise a plan to manage the change process.

2.6. As all major UK banks are affected by the ring-fencing requirements there is a risk that there will be a significant increase in the number of changes to counterparty bank details, which will impact both Treasury and AP/AR[3] operations. Officers have therefore engaged with assurance colleagues from SIAS and SAFS in order to ensure adequate controls are in place to manage any risk of fraud arising from an expected increase in the number of bank account changes impacting suppliers and customers

3. Money Market Fund Regulations
Effective Date: 21 January 2019

3.1. The authority uses a number of Constant Net Asset Value funds to manage liquidity. These are same-day accessible pooled funds which seek to maintain the value of a single share at £1 by managing the underlying fund assets. These were already subject to strict regulation, but the regulation of such funds has been further tightened in new EU regulations published in July. CNAV funds will be replaced by a new Low Volatility Net Asset Value (LVNAV) class, which will be permitted to maintain a constant dealing NAV of £1 provided that strict new rules and minimum liquidity criteria are met.

[3] AP = Accounts Payable – making payments to suppliers
AP = Acounts Receivable – raising invoices for payment for services provided.

3.2. It is expected that most if not all of the Council's existing CNAV MMF portfolio will convert to the LVNAV structure with minimal operational impact. It is expected that there will be no material change arising from the new standard in normal market conditions, but the changes will be reviewed in more detail by Treasury Officers and advisers as the fund managers confirm their plans to ensure that any impacts on security and liquidity of these investments are fully evaluated.

4. Prudential and Treasury Management Codes
Effective from: 2018/19 Financial Year

4.1. The Authority has responded to a consultation launched by CIPFA on changes to the codes.

4.2. Proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council, which will cover the basics of both the capital programme and treasury management. Some Prudential Indicators currently covered within the Treasury Management Strategy Statement [TMSS] would be included in this report, but other indicators may now be delegated to another committee. There may also be changes to some of the existing prudential indicators, and an ability to define local indicators which are more relevant to local conditions.

4.3. Proposed changes to the Treasury Management Code include extending the scope of the code to cover non-treasury investments, such as commercial property investments, as well as loans, guarantees and shares entered into for service purposes. It is proposed that financial guarantees be included as instruments requiring risk management and to be addressed within the TMSS.

4.4. Some of the existing treasury management indicators may be dropped or altered, and approval of the TMSS may be delegated to a committee rather than requiring full council approval.

4.5. The Department of Communities and Local Government (DCLG) and CIPFA wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. It is understood that DCLG will be revising its Investment Guidance (and its MRP guidance) for local authorities in England; however there have been no discussions with the devolved administrations yet.

4.6. CIPFA have stated their intention to publish the two revised codes before the end December 2017, for adoption in 2018/19. This may have impacts on reports requiring approval before the start of 2018/19 and we are advised that CIPFA plans to outline transitional arrangements to manage this impact.

5. Minimum Revenue Provision and Investment Guidance Consultation Due November 2017 for Implementation 2018/19

5.1. The Department for Communities and Local Government have signalled their intention to consult on changes to the guidance it publishes on Minimum Revenue Provision [MRP] and investments.

5.2. At the time of writing the consultation was pending publication, so at this stage the nature and scale of any impacts are uncertain.

5.3. We are advised that changes to MRP guidance may include defined limits on assumptions about the useful life assumptions relating to debt-funded assets, and respond to concerns that some interpretations of the existing guidance may result in less prudent MRP allowances being made by some authorities.

5.4. It is possible that MRP guidance may also change with respect to Property Investments

5.5. It is understood that Central Government has concerns about increasing levels of commercial investment by Local Authorities, particularly as Local Authorities can access capital financing at lower than commercial rates. This spending power has the potential to distort markets and cause asset price bubbles.

5.6. It is considered likely that DCLG will act to tighten up regulation around commercial and property investment to ensure robust governance and sound risk assessment practices.

5.7. Treasury and Capital Accounting will work together to respond to the consultation once published and further updates will be provided as required.