Agenda Item No:

Report to: Cabinet

Date of Meeting: 6 November 2017

Report Title: **Treasury Management - Mid Year Report 2017-18**

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Purpose of Report

This report advises the Cabinet of the Treasury Management activities and performance during the current year. It provides the opportunity to review the Treasury Management Strategy and make appropriate recommendations to Council to take account of any issues or concerns that have arisen since approving it in February 2017.

Recommendation(s)

1. **Cabinet agree the Mid Year report and note that changes to the Prudential Code, Treasury Management Code of Practice and a new Capital Strategy document are all expected to be in place for 2018/19.**
2. **The Audit Committee to consider the substantial implications and risks to the Council at its meeting in January 2018 when considering the proposed Treasury Management Strategy for 2018/19, with a view to making recommendations to the meetings of Cabinet and Council in February 2018.**

Reasons for Recommendations

The Code of Practice on Treasury Management requires, as a minimum, a mid-year review of the Treasury Management Strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved (February 2017). It is a requirement of the Code of Practice that the Mid-year review is considered by Cabinet and full Council.

The Council has increased its levels of income generation and this entails new borrowing over potentially long periods, with consequent risks in terms of asset valuations, credit worthiness, cash and reserve fund availability. Such risks cannot be considered in isolation of all the issues facing the Council now and potentially in the future.

Background

1. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure in combination with funding from reserves. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

2. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing needs of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3. Accordingly, treasury management is defined as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Introduction

4. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council In February 2015.

5. The primary requirements of the Code are as follows:
   - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
   - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
   - Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
   - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
   - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

6. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2017/18 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2017/18;
- A review of the Council's borrowing strategy for 2017/18;
- A review of any debt rescheduling undertaken during 2017/18;
- A review of compliance with Treasury and Prudential Limits for 2017/18.

5. The Committee will need to determine whether there are any issues that require the amendment of the Council's Treasury Management Strategy or Investment Policy and that they therefore wish to draw to the attention of Council. The Audit Committee will consider a similar report at their meeting in January 2018. At the meeting in September 2017 no changes to the 2017/18 strategy were proposed when reviewing the effectiveness of the strategy for 2016/17.

Economic Update

6. UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been weaker; quarter 1 came in at +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

7. The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. The emerging view appears to be that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy is significantly diminishing towards a point at which they now need to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like

a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

8. It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

9. EU. Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4%. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

10. USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

11. Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

12. Japan is struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

Interest rate forecasts

13. The Council's treasury advisor, Capita Asset Services, has provided the following forecast (forecasts below are for PWLB certainty rates).

Interest rate Forecasts – December 2017 to March 2020

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

14. Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

15. There are numerous issues that dampen economic recovery/growth and affect forecasts for UK gilt yields and PWLB rates (besides what final form Brexit will take, when finally agreed with the EU, and when). The downside risks to current rates potentially include:

    i. UK economic growth and inflation
    ii. Weak growth or recession in the UK's main trading partners - the EU and US.
    iii. Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
    iv. A resurgence of the Eurozone sovereign debt crisis.
    v. Weak capitalisation of some European banks.
    vi. Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

16. The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

i. The pace and timing of increases in the United States interest rates causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
ii. UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

The Council's Treasury Position – 30 September 2017

Borrowing

17. The Council's debt and investment position at the 30 September 2017 was as follows:

Table 1 – Borrowing

Debt	1 April 2017 Principal	Rate	Maturity	30 Sept 2017 Principal	Rate
PWLB	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB	£1,000,000	1.63%	2018	£1,000,000	1.63%
PWLB	£2,000,000	0.40% (Variable)	2019	£2,000,000	0.40% (Variable)
PWLB	£909,027	3.78%	2044	£909,027	3.78%
PWLB (Optivo)	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB (FT) (Annuity)	£272,182	1.66%	2026	£258,099	1.66%
PWLB	£1,000,000	2.92%	2056	£1,000,000	2.92%
PWLB	£1,000,000	3.08%	2046	£1,000,000	3.08%
PWLB	£1,000,000	3.01%	2036	£1,000,000	3.01%
PWLB	£1,000,000	2.30%	2026	£1,000,000	2.30%
PWLB	£2,000,000	2.80%	2054	£2,000,000	2.80%
PWLB	£1,000,000	2.42%	2028	£1,000,000	2.42%
PWLB	£2,000,000	2.53%	2057	£2,000,000	2.53%
PWLB	£2,000,000	2.50%	2059	£2,000,000	2.50%
PWLB	£2,000,000	2.48%	2060	£2,000,000	2.48%
PWLB (Annuity)			2057	£7,275,000	2.53%
Total Debt	**£26,469,444**	**3.15%**		**£33,730,361**	**3.02%**

Note: The interest rates applicable are determined at the commencement of the loans, save for the variable rate interest loans.

18. At the 30 September 2017 the Council had debt amounting to £33.73m (PWLB debt).

19. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

20. Part of the Council's treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

21. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

22. The total CFR can also be reduced by:

    - the application of additional capital financing resources (such as unapplied capital receipts); or
    - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

23. The Council's 2017/18 MRP Policy was approved as part of the Treasury Management Strategy Report for 2017/18 by Council in February 2017.

24. The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leased items on the balance sheet, which increase the Council's borrowing need (albeit no additional borrowing is actually required against such items).

Table 2 CFR: General Fund	**2016/17 Actual £000's**	**2017/18 Revised Estimate £000's**
Opening balance	18,064	29,783
Add unfinanced capital expenditure	13,225	9,821
Less Repayments (LAMS)	-1,000	-1,000
Less MRP	-505	-778
Less finance lease arrangements	0	0
Closing balance	29,783	37,826

25. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

26. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2017/18 plus the expected changes to the CFR over 2018/19 and 2019/20 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2017/18.

Table 3 Internal Borrowing	2016/17 Actual £000's	2017/18 (Est) As at 30.9.17 £000's
Capital Financing Requirement	29,783	37,826
External Borrowing	26,469	33,730
Net Internal Borrowing	**3,314**	**4,096**

27. The table above highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Investments in 2017-18

28. The table below provides a snapshot of the investments and deposits held on 30 September 2017. The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

Table 4 – Investments and deposits

Counterparty	Rate/ Return	Start Date	End Date	Principal	Term
NATWEST	0.01%	15/06/2011		£77,191	Call
Lloyds - LAMS	1.97%	26/03/2013	26/03/2018	£1,000,000	Fixed
NATWEST 95 Day Notice	0.10%	21/08/2013		£5,000,021	Call 95 day
Lloyds TSB Bank plc	0.55%	16/05/2017	16/11/2017	£5,000,000	Fixed
Heleba Landesbank Hessen-Thuerin	0.28%	05/06/2017	05/12/2017	£5,000,000	Fixed
Sumitomo Mitsui Bank	0.22%	07/09/2017	09/10/2017	£3,000,000	Fixed
Barclays Corporate	0.40%	25/04/2012		£1,891,864	Call
Santander	0.00%	01/04/2011		£5	Call
Santander	0.10%	15/04/2010		£500	Call
			Total	**£20,969,581**	

29. As at 30 September 2017 three longer term loans are outstanding to other organisations.

Table 5 – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal £	Term
Amicus /Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Foreshore Trust	1.66	21/03/2016	20/03/2026	258,099	Annuity
The Source	2.43	17/12/2015	16/12/2024	22,763	Annuity
			Total	2,069,097	

30. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235- Maturity loan) and the loan to the Foreshore Trust (£300,000 originally borrowed – Annuity loan); these correspond to PWLB loans in Table 1 above.

31. The overall investment performance for the first 6 months of 2017/18 provided an average return of 0.41% (2016/17 0.80%) including the Local Authority Mortgage Scheme (LAMS) and 0.35% (2016/17 0.61%) excluding LAMS.

32. The total interest receivable for the first 6 months is £55,000 (2016/17 £110,000) including the Local Authority Mortgage Scheme and £45,000 (2016/17 £78,000) excluding LAMS. These figures exclude the interest receivable in respect of the three loans to other organisations and income from the Property Fund investment.

The Council's Capital Position (Prudential Indicators)

33. This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

34. **Prudential Indicator for Capital Expenditure**

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure (Net) by Service	2017/18 Original Estimate (net) £'000	2017/18 Revised Estimate (net) £'000
Corporate Resources	500	500
Operational Services	1,618	1,618
New Approvals since Budget:		
Priory Meadow – HBC contribution (£250k over 3 years)		80
Commercial Property (£29m over 2 years)		9,000
Housing (£15m over 3 years)		1,000
Energy (£6m over 3 years)		0
Bottle Alley (Additional £26k)		26
Total Capital Expenditure	2,118	12,224

35. Capital Expenditure – Financing

    The new Capital schemes, approved since the budget, will generally be financed by borrowing, unless Capital receipts from the sale of assets are available.

36. The Priory Meadow Capital investment contribution is expected to be at least self financing although the timing and size of the spend and income streams are, as yet, uncertain.

37. The Cabinet approved the Income Generation Strategy on the 11 September 2017. This includes Capital expenditure of £50m spread over a period of 3 years to be financed from borrowing.

38. The larger schemes in the capital programme which are expected to require financing in 2017/18 from borrowing are:-

    (1) A capital grant to Optivo (previously Amicus Horizon) in respect of Phase 2 of the Coastal Space project in the sum of £875,000.

    (2) The balance of the monies due in respect of BD Foods factory (£110,000)

    (3) The purchase of Bexhill Road retail park (£8.8m)

    (4) Housing Company (Loans estimated at £1m in 2017/18)

39. Impact on the prudential indicators

    There is not unexpectedly a big impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow.

    The Capital Financing Requirement has increased significantly over the last 18 months. It is expected to reach some £75m by 2021/22 (based on the capital

programme approvals to date). The position at 30 September 2017 is shown in Table 3 above, and highlights that there is currently some £4m of self-financing.

40. Compliance with the limits in place for borrowing activity.

    The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and next two financial years.

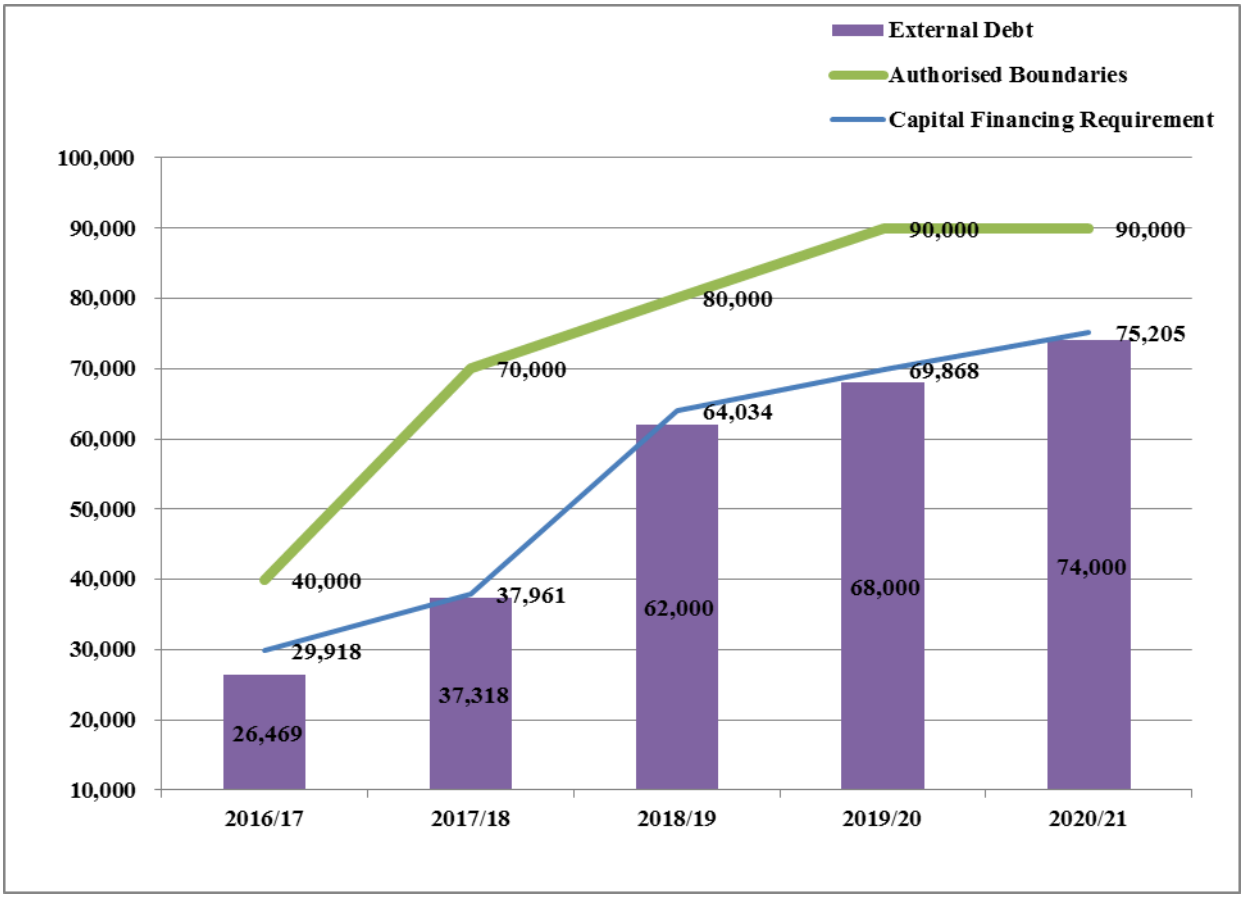
41. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. Currently the operational and authorised limits are the same. In February consideration may need to be given to revising the limits based on the budget approvals and the need to provide cover for short term cash flow requirements.

PRUDENTIAL INDICATOR	2017/18	2018/19	2019/20
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£65,000	£75,000	£85,000
other long term liabilities	£5,000	£5,000	£5,000
TOTAL	£70,000	£80,000	£90,000
Operational Boundary for external debt -			
borrowing	£65,000	£75,000	£85,000
other long term liabilities	£ 5,000	£ 5,000	£ 5,000
TOTAL	£70,000	£80,000	£90,000

42. Currently the authorised and operational boundary limits are the same. The Treasury Management report in February 2018 will recommend that the authorised limit for external debt is increased to allow for short term cash flow borrowing at year end in particular.

43. The graph below shows the current Operational and Authorised boundary levels, the Capital Financing Requirement and estimated external borrowing.

Graph showing estimated CFR/ Debt and Debt boundaries at year end



Borrowing Strategy

44. The Council now has some £33.73m of PWLB debt, and could potentially borrow up to a level of £37.8m (current CFR). This figure does not take account of any new capital spending in future years which could potentially be funded by new borrowing. It should be noted that a £1m PWLB loan is due to be repaid in March 2018. This loan was taken out to fund the second tranche of the Local Authority Mortgage scheme and is matched with a deposit of £1m with Lloyds Bank at an interest rate of 1.9% (which should be repaid to the Council in 2018).

45. The interest rate forecasts from the Council's treasury advisers identify potential increases in base rates by February 2018. Borrowing rates available have increased by some 25bps in recent weeks in expectation of rate rises. Whilst the borrowing rates are attractive on a historical basis the difference between the return on investment and the cost of borrowing remains – the additional revenue cost falling on the Council taxpayer.

46. New borrowing has been taken over the last 18 months, to not only take advantage of the historically low rates, but to ensure that the Council's own reserves are cash backed should restrictions be placed on the amount and levels of borrowing that

authorities can undertake (particularly from the PWLB) and a balanced view will continue to be taken.

47. The plans for income generation, require substantial new borrowing by the Council in the future, play a part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property funds, there has been a much stronger case for reducing the level of internal funding in order to ensure a lower level of borrowing risk in the future.

Debt Rescheduling

48. The Council keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. When reviewed on the 27 September 2017 the early repayment cost of the £7.5m (4.8%) PWLB loan, maturing in 2033, would amount to £3,177,343. No debt rescheduling is being contemplated at present.

Investment Strategy

49. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

50. The Council has a limit of £5m with any one institution (rated A or above, supported by Government, and given a blue (12month) rating by Capita Asset Services). This generally represents a level of up to 15% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

51. The Eurozone and Brexit have led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits if necessary to ensure that monies can be placed with appropriate institutions.

52. The net cost to the Council of borrowing, investment interest and fees will be reviewed as part of the budget setting process.

53. The net interest on the deposits in respect of the LAM scheme for the year will be transferred into the mortgage reserve in order to meet potential defaults (none at present). If at the end of the five year period of the remaining scheme there are no defaults and arrears exceeding 3 months the Council will receive its deposit back in full and would then be able to consider the use of the reserve monies. Such considerations will be included in future budget reports.

Property Fund

54. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered. The £2m was invested in April 2017 and the first dividend actually paid in July 2017. The performance is detailed below:

End of	Sep-17	Aug-17	Jul-17	Jun-17	May-17	Apr-17
Offer Price p	314.48	312.74	310.87	310.22	308.64	307.19
Net Asset Value p	294.60	292.96	291.21	290.60	289.13	287.77
Bid Price p	290.03	288.42	286.70	286.10	284.64	283.31
Dividend~ on XD Date p	3.34			3.34		
Dividend~ - Last 12 Months p	13.13	13.07	13.07	13.07	13.19	13.19
Dividend Yield on NAV %	4.46	4.46	4.49	4.50	4.56	4.58
Fund Size £m	836.2	813.6	776.9	764.7	747.8	710.2

It is important that this is viewed as a longer term investment if the original Capital value is to be recovered.

Compliance with Treasury Limits

55. During the financial year to date there have again been a few occasions where it has not been possible to find institutions to take the Council's money given the strict criteria in place. In these circumstances the Council will place money in its existing call accounts and this can thus result in the investments exceeding general limits. Where such an occasion looks likely to arise the approval of Chief Finance officer is required in compliance with the Council's Treasury Management Practices. The Prudential Indicators have been complied with - reproduced in Appendix 1 for reference.

Financial Implications

56. The Council's 2017/18 budget estimated a 0.50% return on investments. This remains challenging to achieve given the lower interest rates currently available, and the desire of not wishing to invest too long ahead with expectation that interest rates will increase again. However savings from the reduction in borrowing rates should help to ensure overall budget projections are achieved (albeit greatly altered to account for higher Capital expenditure).

Future Changes

57. The Treasury Management Code of Practice (Cipfa) and the Prudential Code for Capital Finance are expected to be revised this year, and a new strategic planning document introduced – the "Capital Strategy" which will seek to bridge the perceived gaps between the Capital programme, funding thereof and Treasury Management. The Capital strategy being a high level document that summarises in appropriate detail:

- the capital schemes that are proposed and their primary objective
- The legal power to undertake a particular scheme
- The key aspects of the financial appraisal, including any significant risks that have been identified
- Qualitative criteria that have underpinned the recommendation for a scheme to proceed e.g. links to Corporate plan, economic growth, job retention, etc
- Likely source of funding
- Long term implications
- Risks and affordability

58. **MiFID II (Markets in Financial Instruments Directive)**

In brief, this directive requires the Council to distinguish itself as either a retail or professional client. In order to qualify for professional status the Council is required to show that it has more than £10m in investments, invests regularly (more than 10 times a quarter), as well as having appropriately trained and experienced staff.

In order for the existing banking and investment counterparties to continue to do business directly with the Council, many forms will need to be completed over the next few months in order to maintain the existing status. The directive becomes law on 1 January 2018.

Risk Management

59. The additional risks that the Council is taking on with commercial property, housing and energy investments will need to be considered in the context of the totality of risk that the Council faces e.g. Pier claim, rates revaluation, robustness of income streams, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

60. The Council spreads its risk on investments by limiting the amount of monies with any one institution or group and limiting the timeframe of the exposure. In determining the level of the investment and period the Council considers formal credit ratings (Fitch) along with its own advisers (Capita Asset Services) ratings advice.

61. The security of the principal sum remains of paramount importance to the Council.

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

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Area(s) Affected

Central Hastings, East Hastings, North St. Leonards, South St. Leonards

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Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No

Appendices – Appendix 1: Prudential Indicators

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APPENDIX 1

Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

PRUDENTIAL INDICATOR	2017/18	2018/19	2019/20
TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£65,000	£75,000	£85,000
other long term liabilities	£5,000	£5,000	£5,000
TOTAL	£70,000	£80,000	£90,000
Operational Boundary for external debt -			
borrowing	£65,000	£75,000	£85,000
other long term liabilities	£ 5,000	£ 5,000	£ 5,000
TOTAL	£70,000	£80,000	£90,000
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %
Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	100%	100%	100%
Upper limit for total principal sums invested/deposited for over 364 days e.g.LAMS Scheme, Coastal Space	£9,000	£9,000	£9,000

Maturity structure of fixed rate borrowing during 2017/18	Upper limit	Lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%