**BABERGH DISTRICT COUNCIL and MID SUFFOLK DISTRICT COUNCIL**

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| **COMMITTEE: Joint Audit and Standards Committee** | **REPORT NUMBER: JAC/18/8** |
| **FROM: Katherine Steel, Assistant Director, Corporate Resources** | **DATE OF MEETING: 12 November 2018** |
| **OFFICER: Melissa Evans, Corporate Manager Finance; Sue Palmer, Senior Financial Services Officer** | **KEY DECISION REF NO. N/A** |

**HALF YEAR REPORT ON TREASURY MANAGEMENT 2018/19**

## 1. PURPOSE OF REPORT

1.1 The report is part of the Councils' management and governance arrangements for Treasury Management activity under the CIPFA Code of Practice on Treasury Management ("the Code"). It provides Members with a comprehensive assessment of activities for the first six months of the financial year 2018/19.

1.2 The report specifically sets out the performance of the treasury management function, the effects of the decisions taken, and the transactions executed during the first six months of 2018/19 and any circumstances of non-compliance with the Councils' treasury management policy statement and treasury management practices.

## 2. OPTIONS CONSIDERED

2.1 This report fulfils the Councils' legal obligations to have regard to the Code and there are no options to consider.

## 3. RECOMMENDATION TO BOTH COUNCILS

3.1 That the Treasury Management activity for the first six months of 2018/19 as set out in Paper JAC/18/8 and Appendices be noted.

**RECOMMENDATION TO BABERGH COUNCIL**

3.2 That it be noted that Babergh District Council Treasury Management activity for the first six months of 2018/19 was in accordance with the approved Treasury Management Strategy, and that the Council has complied with all the Treasury Management Indicators for this period.

**RECOMMENDATION TO MID SUFFOLK COUNCIL**

3.3 That it be noted that Mid Suffolk District Council Treasury Management activity for the first six months of 2018/19 was in accordance with the approved Treasury Management Strategy, and that the Council has complied with all the Treasury Management Indicators for this period.

**REASON FOR DECISION**

**It is a requirement of the Code of Practice on Treasury Management that full Council notes the Mid Year position.**

## 4. KEY INFORMATION

4.1 The 2018/19 Treasury Management Strategy for both Councils was approved in February 2018.

4.2 The Strategy and activities are affected by a number of factors, including the regulatory framework, economic conditions, best practice and interest rate/liquidity risk. The attached appendices summarise the regulatory framework, economic background and information on key activities for the first six months of 2018/19.

4.3 The Joint Treasury Management outturn report for 2017/18 was presented to Members at the Joint Audit and Standards Committee on 30 July 2018.

4.4 The Section 151 Officer is pleased to report that all treasury management activities undertaken complied fully with the CIPFA Code of Practice and the Councils' approved Treasury Management Strategy.

4.5 The Treasury Management Indicators aim to ensure that the capital investments of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice.

4.6 Appendix D shows the position on key Treasury Management Indicators for the first six months of 2018/19.

4.7 The following key points relating to activity for the first half of the year are set out below:

- UK labour market data for July 2018 showed unemployment rate at 4%, its lowest since 1975. However real wages (adjusted for inflation) grew only by 0.2%.
- GDP growth in Q2 of 0.4% appeared to overturn the weakness in Q1 but details show this growth was attributed to an increase in inventories.
- The Bank of England raised the official Bank Rate by 0.25% to 0.75% in August 2018.
- Investment of surplus funds - As market conditions, credit ratings and Bank ring fencing have changed during the year, institutions that the Councils invest with and the period of the investments have been reviewed.
- Credit risk scores were within the benchmark A- credit ratings.
- Babergh's debt reduced by £3.25m due to income exceeding expenditure, which is the normal cash flow profile.
- Mid Suffolk's overall debt increased by £12.85m mainly due to the £16m investment in non-treasury investments (Gateway 14 Ltd). This was offset by the repayment of £3m short term borrowing.

4.8 In terms of the investment of surplus funds Appendix A sets out the issues that are impacting on current and future activity.

4.9 Money market funds, short-term deposits and call accounts are used to make short term investments on a daily basis

4.10 Babergh District Council and Mid Suffolk District Council have maintained strategic investments in Pooled funds whilst reducing their investment in Funding Circle.

## 5. LINKS TO JOINT STRATEGIC PLAN

5.1 Ensuring that the Councils have the resources available underpins the ability to achieve the priorities set out in the Joint Strategic Plan.

## 6. FINANCIAL IMPLICATIONS

6.1 As outlined in this report and appendices.

## 7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

## 8. RISK MANAGEMENT

8.1 This report is most closely linked with the Councils' Significant Business Risk no 5e. "If we do not understand our financial position and respond in a timely and effective way, then we will be unable to deliver the entirety of the Joint Strategic Plan".

8.2 The key risks are set out below:

| Risk Description | Likelihood | Impact | Mitigation Measures |
|---|---|---|---|
| If the Councils lose the investments this will impact on their ability to deliver services. | Highly Unlikely (1) | Bad (3) | Strict lending criteria for high credit rated institutions. |
| If the Councils achieve a poor return on investments, there will be fewer resources available to deliver services. | Highly Probable (4) | Noticeable (2) | Focus is on security and liquidity, and careful cash flow management in accordance with the TM Strategy is undertaken throughout the year. |
| If the Councils have liquidity problems, then they will be unable to meet their short-term liabilities. | Unlikely (2) | Noticeable (2) | As above. |

| Risk Description | Likelihood | Impact | Mitigation Measures |
|---|---|---|---|
| If the Councils incur higher than expected borrowing costs, there will be fewer resources available to deliver services. | Unlikely (2) | Noticeable (2) | Benchmark is to borrow from the Public Works Loan Board (PWLB), whose rates are very low and can be on a fixed or variable basis. Research lowest rates available within borrowing boundaries and use other sources of funding and internal surplus funds temporarily. |

## 9. CONSULTATIONS

9.1 Regular meetings have taken place with the Councils' Treasury advisors, Arlingclose, who also provide important updates on treasury management issues as they arise.

## 10. EQUALITY ANALYSIS

10.1 There are no equality and diversity implications, as the contents and recommendations of this report do not impact on those with protected characteristics.

## 11. ENVIRONMENTAL IMPLICATIONS

11.1 There are no environmental implications related to this report.

## 12. APPENDICES

| Title | Location |
|---|---|
| (a) Background, Economy and Outlook | Attached |
| (b) Borrowing Strategy | Attached |
| (c) Investment Activity | Attached |
| (d) Treasury Management indicators | Attached |
| (e) Glossary of Terms | Attached |

## 13. BACKGROUND DOCUMENTS

13.1 CIPFA's Code of Practice on Treasury Management ("the Code").

13.2 Joint Treasury Management Strategy 2018/19 (Paper JAC17/15).

**Appendix A**

## Background, Economy and Outlook

## 1. Introduction

1.1 In February 2012 both Councils adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Councils to approve treasury management midyear and annual reports.

1.2 The Joint Treasury Management Strategy for 2018/19 was approved at both full Councils in February 2018. Babergh District Council and Mid Suffolk District Council have borrowed and invested substantial sums of money and both are therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Councils' Treasury Management Strategy.

1.3 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. The Ministry of Housing, Communities & Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.

1.4 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. Babergh District Council and Mid Suffolk District Council will be producing its Capital Strategy later in 2018/19 for approval by full Council.

## 2. External Context

### 2.1 Economic background:

2.1.1 Oil prices rose by 23% over the six months to around $82/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year on year, above the consensus forecast and that of the Bank of England in its August Inflation Report, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

2.1.2 The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year on year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking the Bank Rate to 0.75%.

2.1.3 Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018.

2.1.4 The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.

2.1.5 The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29 March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

## 2.2 Financial markets:

2.2.1 Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the bet change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

## 2.3 Credit background:

2.3.1 Reflecting its perceived higher risk, the Credit Default Swap (CDS) spread for non-ringfenced bank NatWest Markets plc rose relatively sharply over the period to around 96bps. The CDS for the ringfenced entity, National Westminster Bank plc, has held steady below 40bps. Although the CDS of other UK banks rose marginally over the period, they continue to remain low compared to historic averages.

2.3.2 The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/NatWest Bank plc – is complete, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

2.3.3 There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1 and NatWest Markets plc to Baa2 from A3 on its view of the credit metrics of the entities post ringfencing. Upgrades to long-term ratings included those for Royal Bank of Scotland plc, NatWest Bank and Ulster Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by S&P and to Aa3 from A1 by Moody's.

2.3.4 The Councils' treasury advisor Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and Certificates of Deposits (CDs) but not senior unsecured bonds issued by commercial banks.

## 3 Outlook for the remainder of 2018/19:

3.1 Having raised interest rates in August 2018 to 0.75%, the Bank of England's Monetary Policy Committee (MPC) has maintained expectations of a slow rise in interest rates over the forecast horizon.

3.2 The MPC has a definite bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that (a) ultra-low interest rates result in other economic problems, and that (b) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise and cuts are required.

3.3 Arlingclose's central case is for Bank Rate to rise twice in 2019. The risks are weighted to the downside. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 of 2018, but the annual growth rate of 1.2% remains well below the long-term average

| | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 |
| Arlingclose Central Ca | 0.75 | 0.75 | 1.00 | 1.00 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 |
| Downside risk | 0.00 | 0.00 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |

3.4 The view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

## 4 Local Context

4.1 On 31 March 2018, Babergh District Council had net borrowing of £93.520m and Mid Suffolk District Council had net borrowing of £107.563m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

4.2 The Councils' current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

4.3 **Table 1: Balance Sheet Summary**

| **Balance Sheet Summary** | **31.3.18 Babergh £m** | **31.3.18 Mid Suffolk £m** |
|---|---|---|
| General Fund CFR | 31.170 | 35.818 |
| HRA CFR | 86.848 | 86.759 |
| **Total CFR** | **118.018** | **122.577** |
| (Less): Usable reserves | (27.081) | (30.736) |
| (Less) / Add: Working capital | 2.583 | 15.722 |
| **Net borrowing** | **93.520** | **107.563** |

4.4 The treasury management position at 30 September 2018 and the change during the half year is show in Table 2 below.

**4.5** **Table 2: Treasury Management Summary**

| **Babergh** | **31.3.18 Balance £m** | **Movement £m** | **30.9.18 Balance £m** | **30.9.18 Rate %** |
|---|---|---|---|---|
| Long-term borrowing | 86.297 | (0.250) | 86.047 | 3.29% |
| Short-term borrowing | 12.000 | (3.000) | 9.000 | 0.75% |
| **Total borrowing** | **98.297** | **(3.250)** | **95.047** | |
| | | | | |
| Long-term investments | 9.638 | (0.208) | 9.430 | 5.50% |
| Short-term investments | 1.000 | (0.250) | 0.750 | 0.51% |
| Cash and Cash equivalents | 1.445 | (0.442) | 1.003 | 0.48% |
| **Total Investments** | **12.083** | **(0.900)** | **11.183** | |
| | | | | |
| **Net borrowing** | **86.214** | | **83.864** | |

**Appendix A cont'd**

| Mid Suffolk | 31.3.18 Balance £m | Movement £m | 30.9.18 Balance £m | 30.9.18 Rate % |
|---|---|---|---|---|
| Long-term borrowing | 74.087 | 15.850 | 89.937 | 2.99% |
| Short-term borrowing | 29.000 | (3.000) | 26.000 | 0.73% |
| **Total borrowing** | **103.087** | **12.850** | **115.937** | |
| | | | | |
| Long-term investments | 9.642 | (0.219) | 9.423 | 5.46% |
| Short-term investments | 1.500 | (1.500) | 0.000 | 0.55% |
| Cash and Cash equivalents | 0.894 | 0.370 | 1.264 | 0.43% |
| **Total Investments** | **12.036** | **(1.349)** | **10.687** | |
| | | | | |
| **Net borrowing** | **91.051** | | **105.250** | |

**Appendix B**

## 1 Borrowing Strategy

1.1 At 30 September 2018 Babergh held £95.047m of loans, a decrease of £3.25m, Mid Suffolk held £115.937m of loans, an increase of £12.85m as part of its strategy for funding previous years' capital programmes and investment in the Gateway 14 Ltd project. The borrowing position at 30 September 2018 is shown in Table 3 below.

### 1.2 Table 3: Borrowing Position

| Babergh | 31.3.18 Balance £m | Movement £m | 30.9.18 Balance £m | 30.9.18 Weighted Average Rate % |
|---|---|---|---|---|
| Public Works Loan Board | 86.297 | (0.250) | 86.047 | 3.29% |
| Local authorities (short term) | 12.000 | (3.000) | 9.000 | 0.75% |
| **Total borrowing** | **98.297** | **(3.250)** | **95.047** | |

| Mid Suffolk | 31.3.18 Balance £m | Movement £m | 30.9.18 Balance £m | 30.9.18 Weighted Average Rate % |
|---|---|---|---|---|
| Public Works Loan Board | 70.087 | (0.150) | 69.937 | 3.56% |
| Banks (LOBO) | 4.000 | 0.000 | 4.000 | 4.21% |
| Local authorities (Long term) | 0.000 | 16.000 | 16.000 | 1.20% |
| Local authorities (short term) | 29.000 | (3.000) | 26.000 | 0.73% |
| **Total borrowing** | **103.087** | **12.850** | **115.937** | |

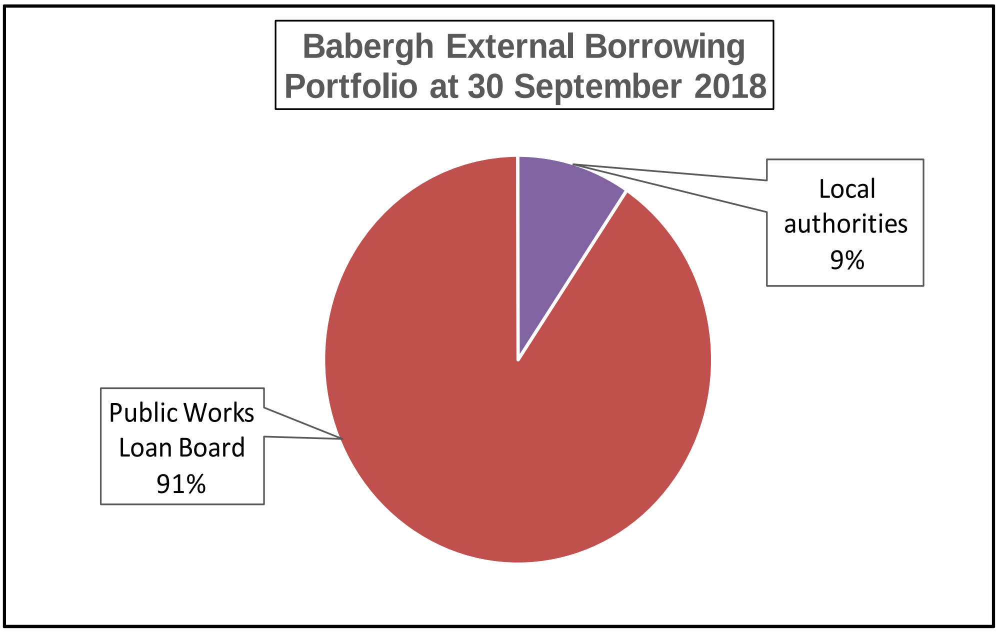
1.3 The Councils' chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Councils' long-term plans change being a secondary objective.

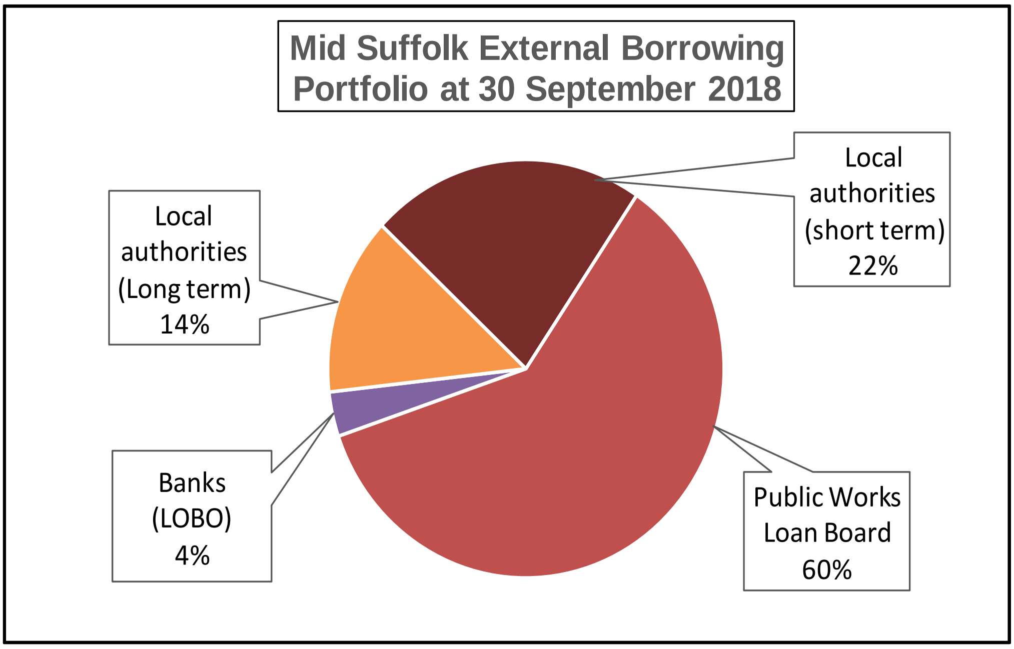
1.4 With short-term interest rates remaining much lower than long-term rates, the Councils considered it more cost effective in the near term to use internal resources or short-term loans instead.

1.5 As the Councils have increasing CFR's due to the capital programme and an estimated borrowing requirement as determined by the Liability Benchmark which also takes into account usable reserves and working capital, Mid Suffolk borrowed £16m medium/longer-term fixed rate loans to provide some longer-term certainty and stability to the debt portfolio and stay within short term borrowing limits.

**1.6** LOBO loans: Mid Suffolk continues to hold £4m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during the first half year of 2018/19.

**1.7** **<u>The Councils' Borrowing Portfolios at 30 September 2018 below:</u>**



**Appendix C**

# 1 Investment Activity

1.1 The Councils hold invested funds, representing income received in advance of expenditure plus balances and reserves held. During the first half of 2018/19, Babergh's investment balance ranged between £11.183m and £18.926m. Mid Suffolk's investment balance ranged between £10.687m and £32.354m. These movements are due to timing differences between income and expenditure.

The investment position and weighted average rates during the first six months of the year is shown in Table 4 below.

## 1.2 Table 4: Treasury Investment Position

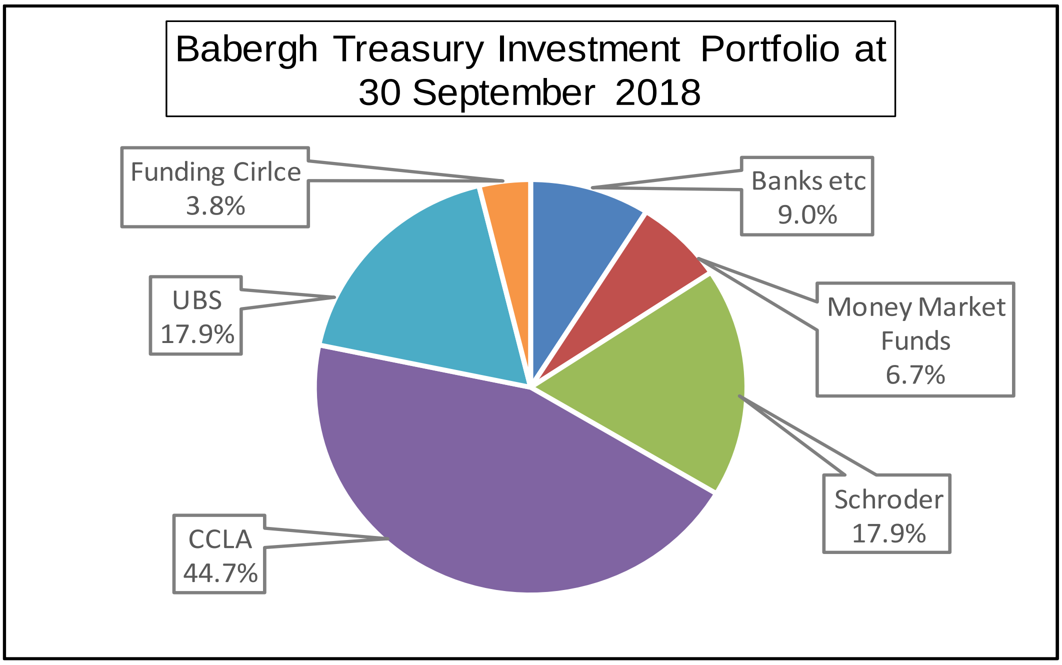
| Babergh | 31.3.18 Balance £m | Movement £m | 30.9.18 Balance £m | 30.9.18 Weighted Average Rate % |
|---|---|---|---|---|
| Banks and Building Societies | 1.445 | (0.442) | 1.003 | 0.48% |
| Money Market Funds | 1.000 | (0.250) | 0.750 | 0.51% |
| Other Pooled Funds | 9.638 | (0.208) | 9.430 | 5.50% |
| **Total Investments** | **12.083** | **(0.900)** | **11.183** | |

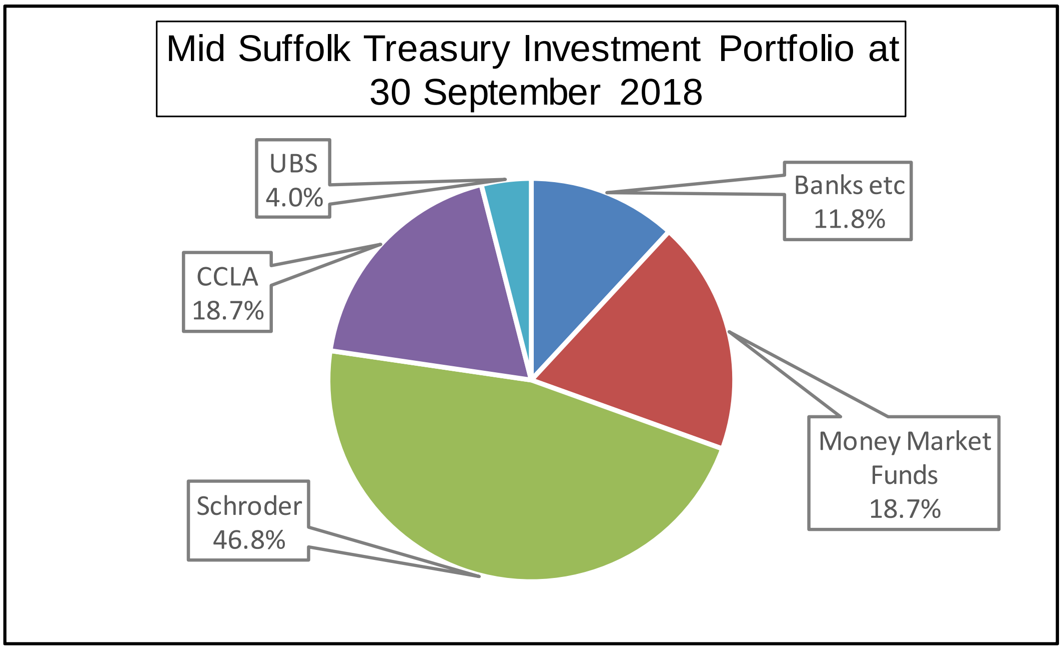
| Mid Suffolk | 31.3.18 Balance £m | Movement £m | 30.9.18 Balance £m | 30.9.18 Weighted Average Rate % |
|---|---|---|---|---|
| Banks and Building Societies | 0.894 | 0.370 | 1.264 | 0.43% |
| Money Market Funds | 1.500 | (1.500) | 0.000 | 0.55% |
| Other Pooled Funds | 9.642 | (0.219) | 9.423 | 5.46% |
| **Total Investments** | **12.036** | **(1.349)** | **10.687** | |

1.3 Both the CIPFA Code and government guidance require the Councils to invest their funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Councils' 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.

1.4 Given the increasing risk and falling returns from short-term unsecured bank investments, the Councils diversified into more higher yielding asset classes; pooled property, multi asset and equity funds. As a result, investment risk was diversified while the average rate of return has increased. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 that follows.

**1.5 <u>The Councils' Investment Portfolios at 30 September 2018 below:</u>**



1.6 **Table 5: Investment Benchmarking – Treasury investments managed in-house**

| Babergh | Credit Score | Credit Rating | Bail-in Exposure | Weighted Average Maturity (days) | Rate of Return |
|---|---|---|---|---|---|
| 31.03.2018 | 6.21 | A | 85% | 164 | 5.10% |
| 30.06.2018 | 5.55 | A | 91% | 119 | 5.30% |
| 30.09.2018 | 5.71 | A | 85% | 185 | 5.23% |
| Similar LAs | 4.28 | AA- | 56% | 88 | 1.41% |
| All LAs | 4.38 | AA- | 60% | 37 | 1.25% |

| Mid Suffolk | Credit Score | Credit Rating | Bail-in Exposure | Weighted Average Maturity (days) | Rate of Return |
|---|---|---|---|---|---|
| 31.03.2018 | 5.85 | A | 85% | 158 | 5.08% |
| 30.06.2018 | 5.43 | A+ | 93% | 95 | 4.97% |
| 30.09.2018 | 5.88 | A | 81% | 232 | 5.43% |
| Similar LAs | 4.28 | AA- | 56% | 88 | 1.41% |
| All LAs | 4.38 | AA- | 60% | 37 | 1.25% |

1.7 Babergh has £9.430m of externally managed pooled equity, property and multi assets funds which generated an average total income return, since the date of the initial investments, of £1.172m (5.10%) which is used to support service provision.

1.8 Mid Suffolk has £9.423m of externally managed pooled equity, property and multi assets funds which generated an average total income return, since the date of the initial investments, of £1.031m (5.08%) which is used to support service provision.

1.9 These funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Councils' investment objectives are regularly reviewed. In light of their performance and the Councils' latest cash flow forecasts, investment in these funds has been maintained.

1.10 During the year the Ministry of Housing, Communities and Local Government (MHCLG) consulted on statutory overrides relating to the IFRS 9 Financial Instruments accounting standard from 2018/19. The consultation recognised that the requirement in IFRS 9 for certain investments to be accounted for as fair value through profit and loss may introduce "more income statement volatility" which may impact on budget calculations. The consultation proposed a time-limited statutory override and sought views whether it should be applied only to pooled property funds. Both Councils responded to the consultation which closed on 28 September 2018.

## 2 Long Term investments – Pooled Fund Performance

2.1 Babergh and Mid Suffolk both have investments in pooled funds to generate an income return. Table 6 below is a summary of performance by fund from initial investment date until the most recent return valuation available and details of interest received.

### 2.2 Table 6: Pooled Fund Performance

| **Fund** | **Babergh** | **Mid Suffolk** |
|---|---|---|
| | **£** | **£** |
| **CCLA** | | |
| Amount invested | 5,000,000 | 5,000,000 |
| Value at 30.9.2018 | 4,953,434 | 4,876,817 |
| **Movement** | **(46,566)** | **(123,183)** |
| Net Interest earned to 30.9.2018 | 689,343 | 642,198 |
| Average return | 4.47% | 4.40% |
| | | |
| **UBS** | | |
| Amount invested | 2,000,000 | 2,000,000 |
| Value at 30.9.2018 | 1,983,483 | 1,983,483 |
| **Movement** | **(16,517)** | **(16,517)** |
| Interest earned to 30.6.2018 | 213,611 | 117,416 |
| Average return | 3.88% | 3.91% |
| | | |
| **Schroders** | | |
| Amount invested | 2,000,000 | 2,000,000 |
| Value at 30.9.2018 | 1,932,337 | 1,928,922 |
| **Movement** | **(67,663)** | **(71,078)** |
| Interest earned to 30.5.2018 | 191,334 | 191,334 |
| Average return | 7.65% | 7.65% |
| | | |
| **Funding Circle** | | |
| Amount invested | 429,927 | 422,757 |
| Value at 8.10.2018 | 415,012 | 399,523 |
| **Movement** | **(14,914)** | **(23,234)** |
| Interest earned to 30.6.2018 | 77,237 | 80,142 |
| Average return | 5.97% | 5.83% |
| | | |
| **Total Pooled Funds** | | |
| Amount invested | 9,429,927 | 9,422,757 |
| Values | 9,284,266 | 9,188,745 |
| **Movement** | **(145,661)** | **(234,012)** |
| Interest earned | 1,171,525 | 1,031,090 |
| Average return | 5.10% | 5.08% |

## 3 Other Investment Activity

3.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Councils as well as other non-financial assets which the Councils hold primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to include all such assets held partially for financial return.

3.2 On 5 August 2016 Babergh purchased Borehamgate Shopping centre in Sudbury for £3.56m. This has been classified as an investment property and on 31 March 2018, the District Valuer assessed its Fair Value at £3.5m, generating rental returns of £0.072m to 30 September 2018.

3.3 Babergh holds £1.766m of equity in Babergh Holdings Ltd and has £15.898m of loans in Capital Investment Fund Company (CIFCO), a subsidiary of Babergh Holdings Ltd. These loans have generated £0.410m of investment income since the start of trading.

3.4 Mid Suffolk holds £1.766m of equity in Mid Suffolk Holdings Ltd and has £15.898m of loans in Capital Investment Fund Company (CIFCO), a subsidiary of Mid Suffolk Holdings Ltd. These loans have generated £0.410m of investment income since the start of trading.

3.5 Mid Suffolk also holds £16.178m of investment in another subsidiary of Mid Suffolk Holdings Ltd, Gateway 14 Ltd, which has generated £0.099m of accrued investment income since 13 August 2018.

## 4 Table 7: Debt Limits

4.1 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 7 below.

| Borrowing | Actual Maximum | 30.9.18 Actual | 2018/19 Operational Boundary | 2018/19 Authorised Limit | Complied |
|---|---|---|---|---|---|
| Babergh | £98.297m | £95.047m | £138m | £148m | ✓ |
| Mid Suffolk | £118.087m | £115.937m | £156m | £166m | ✓ |

4.2 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure

## 5 Compliance

5.1 The Section 151 Officer is pleased to report that all treasury management activities undertaken complied fully with the CIPFA Code of Practice and the Councils' approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in Table 8 that follows.

## 5.2 Table 8: Investment Limits

| **Babergh** | **Actual Maximum** | **30.9.18 Actual** | **2018/19 Limit** | **Complied** |
|---|---|---|---|---|
| Lloyds Bank | £1.848m | £1.003m | £2m | ✓ |
| Money market funds | 44.91% | 6.71% | 50% | ✓ |
| DMADF | Nil | Nil | No limit | ✓ |
| CCLA | £5m | £5m | £5m | ✓ |
| UBS | £2m | £2m | £5m | ✓ |
| Schroder | £2m | £2m | £5m | ✓ |
| Funding Circle | £0.638m | £0.430m | £1m | ✓ |

| **Mid Suffolk** | **Actual Maximum** | **30.9.18 Actual** | **2018/19 Limit** | **Complied** |
|---|---|---|---|---|
| Lloyds Bank | £1.927m | £1.264m | £2m | ✓ |
| Barclays Bank | £0.500m | Nil | £2m | ✓ |
| Svenska Handelsbanken | Nil | Nil | £2m | ✓ |
| Money market funds | 35.63% | 0.00% | 50% | ✓ |
| DMADF | £15.500m | Nil | No limit | ✓ |
| CCLA | £5m | £5m | £5m | ✓ |
| UBS | £2m | £2m | £5m | ✓ |
| Schroder | £2m | £2m | £5m | ✓ |
| Funding Circle | £0.642m | £0.423m | £1m | ✓ |

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**Appendix D**

## 1 Treasury Management Indicators

1.1 The Councils measure and manage their exposure to treasury management risks using the following indicators.

1.2 **Security:** The Councils have adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of their investment portfolios. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| **Portfolio Average Credit Score** | **30.9.18 Actual** | **2018/19 Target** | **Complied** |
|---|---|---|---|
| Babergh | 5.71 | 7.0 | ✓ |
| Mid Suffolk | 5.88 | 7.0 | ✓ |

1.3 **Interest Rate Exposures:** This indicator is set to control the Councils' exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed was:

| **Babergh** | **30.9.18 Actual** | **2018/19 Target** | **Complied** |
|---|---|---|---|
| Upper limit on fixed interest rate exposure | £86.047m | £136m | ✓ |
| Upper limit on Variable interest rate exposure | (£2.183m) | £35m | ✓ |

| **Mid Suffolk** | **30.9.18 Actual** | **2018/19 Target** | **Complied** |
|---|---|---|---|
| Upper limit on fixed interest rate exposure | £89.937m | £154m | ✓ |
| Upper limit on Variable interest rate exposure | £15.313m | £40m | ✓ |

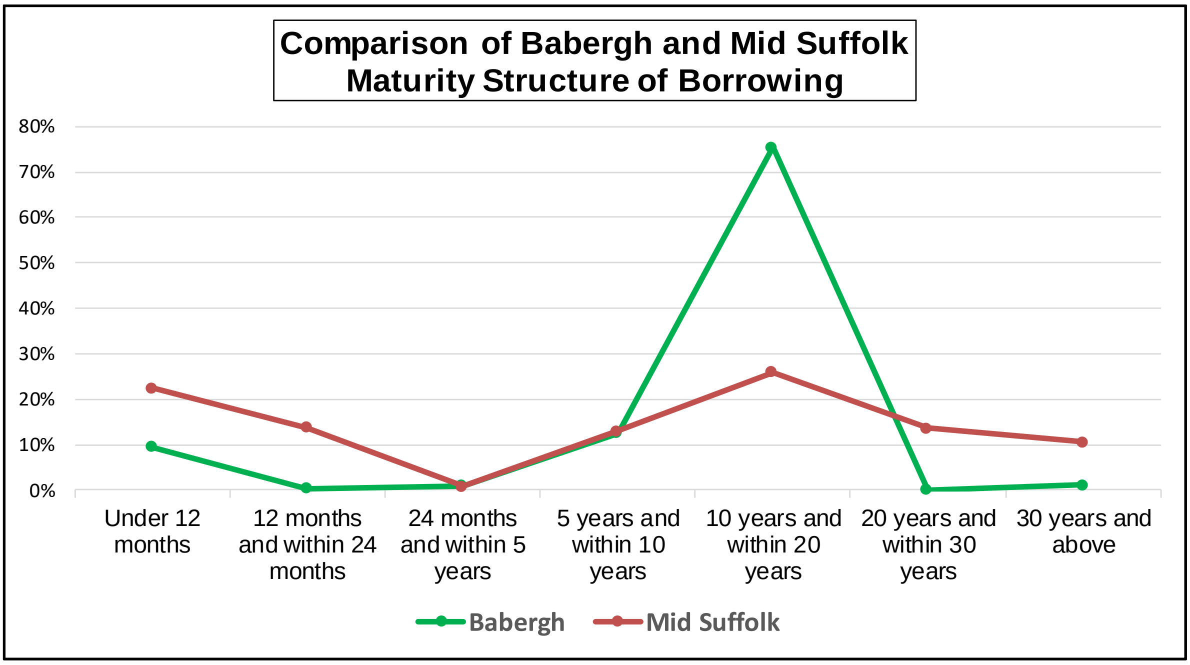
1.4 Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

1.5 **Maturity Structure of Borrowing:** This indicator is set to control the Councils' exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

| **Babergh** | **30.9.18 Actual** | **Lower Limit** | **Upper Limit** | **Complied** |
|---|---|---|---|---|
| Under 12 months | 9.47% | 0 | 50% | ✓ |
| 12 months and within 24 months | 0.42% | 0 | 50% | ✓ |
| 24 months and within 5 years | 0.95% | 0 | 50% | ✓ |
| 5 years and within 10 years | 12.63% | 0 | 100% | ✓ |
| 10 years and within 20 years | 75.38% | 0 | 100% | ✓ |
| 20 years and within 30 years | 0.00% | 0 | 100% | ✓ |
| 30 years and above | 1.16% | 0 | 100% | ✓ |

| **Mid Suffolk** | **30.9.18 Actual** | **Lower Limit** | **Upper Limit** | **Complied** |
|---|---|---|---|---|
| Under 12 months | 22.43% | 0 | 50% | ✓ |
| 12 months and within 24 months | 13.80% | 0 | 50% | ✓ |
| 24 months and within 5 years | 0.78% | 0 | 50% | ✓ |
| 5 years and within 10 years | 12.94% | 0 | 100% | ✓ |
| 10 years and within 20 years | 25.88% | 0 | 100% | ✓ |
| 20 years and within 30 years | 13.55% | 0 | 100% | ✓ |
| 30 years and above | 10.64% | 0 | 100% | ✓ |

**1.6 <u>Chart to show the Maturity Structure of Borrowing:</u>**




1.7 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

1.8 **Principal Sums Invested for Periods Longer than 365 days:** The purpose of this indicator is to control the Councils' exposure to the risk of incurring losses by seeking early repayment of their investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

| **Actual Principal invested beyond year end** | **2018/19** | **2019/20** | **2020/21** |
|---|---|---|---|
| Babergh Actual | Nil | Nil | Nil |
| Mid Suffolk Actual | Nil | Nil | Nil |
| **Limit on principal invested beyond year end** | **£2m** | **£2m** | **£2m** |
| Babergh Complied | ✓ | ✓ | ✓ |
| Mid Suffolk Complied | ✓ | ✓ | ✓ |

**Appendix E**

## Glossary of Terms

| | |
|---|---|
| BPS | Base Points. A unit of percentage measure equal to 0.01%. Basis points are commonly used when discussing changes to interest rates, equity indices, and fixed-income securities. |
| CDS | Credit Default Swap. In effect, insurance against non-payment. Through a CDS, the buyer can mitigate the risk of their investment by shifting all or a portion of that risk onto an insurance company or other CDS seller in exchange for a periodic fee. In this way, the buyer of a credit default swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the debt security. |
| CFR | Capital Financing Requirement. The underlying need to borrow to finance capital expenditure. |
| CIPFA | The Chartered Institute of Public Finance and Accountancy. This is the leading professional accountancy body for public services. |
| CLG | Department for Communities and Local Government. This is a ministerial department. |
| CPI | Consumer Price Index. This measures changes in the price level of consumer goods and services purchased by households. |
| CPIH | Consumer Price Index Housing. A measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH). |
| CCLA | Churches, Charities and Local Authority Property Fund |
| DMADF | Debt Management Account Deposit Facility. |
| Funding Circle | Accounts set up to lend money to local and national businesses at competitive rates |
| GDP | Gross Domestic Product. This is the market value of all officially recognised goods and services produced within a country in a given period of time. |
| HRA | Housing Revenue Account. The statutory account to which revenue costs are charged for providing, maintaining and managing Council dwellings. These costs are financed by tenants' rents. |
| LIBID | London Interbank Bid Rate. The interest rate at which banks bid to take short-term deposits from other banks in the London interbank market. |
| LOBO | Lender's Option Borrower's Option. This is a loan where the lender has certain dates when they can increase the interest rate payable and, if they do, the Council has the option of accepting the new rate or repaying the loan |
| LVNAV | Low Volatility Net Asset Value. A new type of Low Volatility Net Asset Value Money Market Fund - a new fund category introduced as part of a new regulatory reform of the sector in Europe. |

| | |
|---|---|
| MiFiD | The Markets in Financial Instruments Directive (2014/65/EU) (MiFID II). The EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. |
| MPC | Monetary Policy Committee. A committee of the Bank of England which decides the Bank of England's Base Rate and other aspects of the Government's Monetary Policy. |
| MRP | Minimum Revenue Provision. Local authorities are required to make a prudent provision for debt redemption on General Fund borrowing |
| NAV | Net Asset Value. The NAV is the value of a fund's assets less the value of its liabilities on a per unit basis. |
| PWLB | Public Works Loan Board - offers loans to local authorities below market rates. |
| QE | Quantitative Easing. The purchase of Government bonds by the Bank of England to boost the money supply. |
| T Bills | Treasury Bill. A short-term Government Bond. |
| UBS | UBS Multi Asset Income Fund (UK) – a pooled fund. |