BABERGH DISTRICT COUNCIL and MID SUFFOLK DISTRICT COUNCIL

From: Cabinet Members - Finance	**Report Number: JAC/17/10**
To: Joint Audit and Standards Committee	**Date of meeting: 13 November 2017**

MID YEAR REPORT ON TREASURY MANAGEMENT 2017/18

1. Purpose of Report

1.1. The Code of Practice on Treasury Management requires local authorities to present a mid-year report on treasury management activities to those Members charged with scrutinising this area of activity. This report fulfils that requirement and sets out treasury management activities for the first half of 2017/18.

2. Recommendations

2.1 That Mid Suffolk District Council Treasury Management activity for the first six months of 2017/18 was in accordance with the approved Treasury Management Strategy, and that the Council has complied with all the Treasury Management Indicators for this period be recommended to Council for noting.

2.2 That Babergh District Council Treasury Management activity for the first six months of 2017/18 was in accordance with the approved Treasury Management Strategy, and that, except for one occasion when the Council exceeded their daily bank account limit with Lloyds by £120k for one day, as mentioned in Appendix D, paragraph 1.1., the Council has complied with all the Treasury Management Indicators for this period be recommended to Council for noting.

3. Financial implications

3.1 As outlined in this report.

4. Legal implications

4.1 There are no legal implications arising from this report.

5. Risk Management

5.1 This report is most closely linked with the Councils' Significant Business Risks no. 5f. 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. It should be noted that changes in funding requirements, interest rates and other external factors can impact on the medium term financial strategy and future budgets. Further key risks around treasury management, are set out below:

Risk description	Likelihood	Impact	Mitigation measures
If the Councils lose the investments they hold then the loss of income could impact on their ability to fund and deliver services.	Highly Unlikely (1)	Bad (3)	The Councils have strict lending criteria, investing only in high credit rated institutions.
If the Councils achieve a poor return on their investments, then there will be fewer resources available to deliver services (applicable to Babergh only).	Highly Unlikely (1)	Bad (3)	Focus is on security and liquidity, followed by yield, and careful cash flow management 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.
If the Councils incur higher than expected borrowing costs, then there will be fewer resources available to deliver services.	Unlikely (2)	Noticeable (2)	Research is undertaken to borrow at the lowest rates available. The Councils are able to borrow from the Public Works Loan Board (PWLB), whose rates are very low and can be on a fixed or variable basis.

6. Consultations

6.1 Regular meetings have taken place with our Treasury advisors, Arlingclose, who also provide important updates on treasury management issues as they arise.

7. Equality Analysis

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

8. Shared Service / Partnership Implications

8.1 This is a joint report on activity. The Joint Treasury Management Strategy and related operations are handled by the integrated in-house Finance Team.

9. Links to Joint Strategic Plan

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

10. Key Information

10.1 The Joint Treasury Management Strategy for 2017/18 was approved at each Full Council in February 2017.

10.2 Several factors affect the strategy and activities, 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 2017/18.

10.3 The Joint Treasury Management outturn report for 2016/17 was presented to Members at the Joint Audit and Standards Committee on 17 July 2017.

10.4 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.

10.5 Appendix D shows the position on key Treasury Management Indicators for the first six months of 2017/18.

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

- The UK economy has continued to grow but at a much slower pace in the first six months of 2017/18 with output growing by 0.2% in Q1and 0.3% in Q2. However, the recent headlines for Q3 announced at the end of October indicate that this has increased to 0.4%.
- The result of the EU referendum has resulted in growth forecasts being downgraded as 2017 has progressed.
- Investment of surplus funds - As market conditions and credit ratings 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 £6.2m and Mid Suffolk’s by £8.15m due to income exceeding expenditure, which is the normal cash flow profile.
- No new long-term external borrowing.

10.7 In terms of the investment of surplus funds, section 2.3 onwards in Appendix A sets out the issues that are impacting on current and future activity.

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

11. Appendices

Title	Location
(a) Background, Economy and Outlook	Attached
(b) Debt Management	Attached
(c) Investment Activity	Attached
(d) Treasury Management indicators	Attached
(e) Glossary	Attached

12. Background Documents

None.

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Appendix A

Background, Economy and Outlook

1. Background

1.1 Both Councils have adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Councils to approve treasury management mid-year and annual outturn reports.

1.2 The Councils' Joint Treasury Management Strategy for 2017/18 was approved at full Council meetings held by each Council in February 2017.

1.3 The Councils define their treasury management activities in line with the CIPFA definition as: "the management of the organisation's investments and cash flows, it's banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance associated with those risks."

1.4 In addition to reporting on risk management related to treasury activities, the Treasury Management Code also requires the Councils to report on any financial instruments entered into to manage treasury risks.

1.5 Both Councils have borrowed and invested substantial sums of money and 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 both Councils' treasury management strategy.

1.6 The instruments and the limits with individual counterparties approved in the 2017/18 Treasury Management Strategy of each Council are as follows:

Type of Instrument	Babergh Limit	Mid Suffolk Limit
Deposits with banks and building societies	£2m	£1m
AAA rated money market funds	£2m	£2m
Deposits with other local authorities	£1m	£1m
Treasury bills	No limit	No limit
Debt Management Account Deposit Facility	No limit	No limit
Pooled Funds	£5m	£5m
Registered Providers	£5m	£5m
Corporates	£1m	£1m

1.7 The total limits for non-specified investments are shown in the following below:

Non-Specified Investment Limits	**Babergh & Mid Suffolk Limit**
Total investments without credit ratings	£10m
Total non – specified investments	£10m
Total loans to unrated corporates	£1m

2. Economic Commentary

2.1 Economic Backdrop

2.1.1 Commodity prices fluctuated over the period with oil falling below $45 a barrel before inching back up to $58 a barrel. UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.7%.

2.1.2 The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth. With household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar year 2017.

2.1.3 The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". The Council's treasury advisor Arlingclose are not convinced the UK's economic outlook justifies such a move at this stage, but the Bank's interpretation of the data seems to have shifted.

2.1.4 In contrast, near-term global growth prospects improved. The US Federal Reserve (Fed) increased its target range of official interest rates in June for the second time in 2017 by 25bps (basis points) to between 1% and 1.25% and, despite US inflation hitting a soft patch with core CPI at 1.7%, a further similar increase is expected in its December 2017 meeting. The Fed also confirmed that it would be starting a reversal of its vast Quantitative Easing programme and reduce the $4.2 trillion of bonds it acquired by initially cutting the amount it reinvests by $10bn a month.

2.1.5 Geopolitical tensions escalated in August as the US and North Korea exchanged escalating verbal threats over reports about enhancements in North Korea's missile programme. The provocation from both sides helped wipe off nearly $1 trillion from global equity markets but benefited safe-haven assets such as gold, the US dollar and the Japanese yen. Tensions remained high, with North Korea's threat to fire missiles towards the US naval base in Guam, its recent missile tests over Japan and a further testing of its latent nuclear capabilities.

2.1.6 Prime Minister Theresa May called an unscheduled General Election in June, to resolve uncertainty but the surprise result has led to a minority Conservative government in coalition with the Democratic Unionist Party. This clearly results in an enhanced level of political uncertainty. Although the potential for a so-called hard Brexit is diminished, lack of clarity over future trading partnerships, in particular customs agreements with the rest of the EU block, is denting business sentiment and investment. The reaction from the markets on the UK election's outcome was fairly muted, business confidence now hinges on the progress (or not) of Brexit negotiations, the ultimate 'divorce bill' for the exit and whether new trade treaties and customs arrangements are successfully concluded to the UK's benefit.

2.1.7 In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take only a very measured approach to any monetary policy tightening, any increase will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition.

2.2 <u>Financial Markets</u>

2.2.1 Gilt yields displayed significant volatility over the six-month period with the appearing change in sentiment in the Bank of England's outlook for interest rates, the push-pull from expectations of tapering of Quantitative Easing (QE) in the US and Europe and from geopolitical tensions, which also had an impact. The yield on the 5-year gilts fell to 0.35% in mid-June, but then rose to 0.80% by the end of September. The 10-year gilts similarly rose from their lows of 0.93% to 1.38% at the end of the quarter, and those on 20-year gilts from 1.62% to 1.94%.

2.2.2 The FTSE 100 nevertheless powered away reaching a record high of 7548 in May but dropped back to 7377 at the end of September. Money market rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.30% and 0.65% over the period from January to 21 September.

2.3 Credit Background

2.3.1 UK bank credit default swaps continued their downward trend, reaching three-year lows by the end of June. Bank share prices have not moved in any particular pattern.

2.3.2 There were a few credit rating changes during the quarter. The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1, placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide and Coventry Building Society from negative to stable but downgraded the long-term rating of Leeds BS from A2 to A3.

2.3.3 Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, Arlingclose advised the Councils to reduce the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months, as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain. Neither council has placed investments with these banks during the first half of the year.

2.3.4 The new EU regulations for Money Market Funds (MMFs) were finally approved and published in July and existing funds will have to be compliant by no later than 21 January 2019. The key features include Low Volatility Net Asset Value (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends to be converted to the LVNAV structure and awaits confirmation from each fund.

Appendix A

3. Outlook for the remainder of 2017/18

3.1 The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Both consumer and business confidence remain subdued. Household consumption growth, the driver of UK GDP growth, has softened following a contraction in real wages. Savings rates are at an all-time low and real earnings growth (i.e. after inflation) struggles in the face of higher inflation.

3.2 This decision is still very data dependant and Arlingclose are, for now, maintaining its central case for Bank Rate at 0.25% whilst introducing near-term upside risks to the forecast as shown below. Arlingclose’s central case is for gilt yields to remain broadly stable across the medium term, but there may be near term volatility due to shifts in interest rate expectations.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Official Bank Rate													
Upside risk	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Downside risk	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25

4. Regulatory Updates

4.1 MiFID II

4.1.1 Local authorities are currently treated by regulated financial services firms (the firm) as professional clients who can “opt down” to be treated as retail clients instead. However, from 3 January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can “opt up” to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the Councils must have an investment balance of at least £10 million each and the person authorised to make investment decisions on behalf of the Councils must have at least one year’s relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

4.1.2 The main additional protection for retail clients is a duty on the firm to ensure that the investment is “suitable” for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients.

4.1.3 It is also likely that retail clients will face increased costs and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Councils have declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

4.1.4 Both councils meet the conditions to opt up to professional status and intend to do so to maintain their current MiFID status.

4.2 CIPFA Consultation on Prudential and Treasury Management Codes

4.2.1 In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses they launched a further consultation on changes to the codes in August with a deadline for responses of 30 September 2017. Both Councils submitted a response to the consultation, which can be found on our website.

4.2.2 The 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 the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

4.2.3 Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of "investments" as well as loans made or shares bought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Joint Treasury Management Strategy. Approval of the technical detail of the Joint Treasury Management Strategy may be delegated to a committee rather than needing approval of Full Council. There are also plans to drop or alter some of the current treasury management indicators.

4.2.4 CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year. 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.

Appendix A

5. Local Context

5.1 On 31 March 2017 Babergh had net borrowing of £76.739m and Mid Suffolk £96.235m, arising from their 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.

Table 1: Underlying need to borrow

Balance Sheet Summary	31.3.17 Babergh £m	31.3.17 Mid Suffolk £m
General Fund CFR	18.609	22.241
HRA CFR	86.253	86.759
Total CFR	**104.862**	**109.000**
(Less): Usable reserves	(22.254)	(22.723)
(Less) / Add: Working capital	(5.869)	9.958
Net borrowing	**76.739**	**96.235**

5.2 The Councils strategy is to maintain borrowing and investments below their underlying levels (as shown in Appendix D), sometimes known as internal borrowing, to reduce risk and keep interest costs low. The treasury management position at 30 September 2017 and the change over the first half of the year is shown in Table 2 below.

Table 2: Treasury Management Summary

Babergh	31.3.17 Balance £m	Movement £m	30.9.17 Balance £m	30.9.17 Rate %
Long-term borrowing	86.797	(0.250)	86.547	3.21%
Short-term borrowing	6.000	(6.000)	0.000	0.43%
Total borrowing	**92.797**	**(6.250)**	**86.547**	
Long-term investments	9.638	0.000	9.638	5.80%
Short-term investments	2.700	2.100	4.800	0.18%
Cash and Cash equivalents	3.389	(2.515)	0.874	0.14%
Total Investments	**15.727**	**(0.415)**	**15.312**	
Net borrowing	**77.070**		**71.235**	

Appendix A

Mid Suffolk	31.3.17 Balance £m	Movement £m	30.9.17 Balance £m	30.9.17 Rate %
Long-term borrowing	74.887	(0.650)	74.237	3.55%
Short-term borrowing	22.500	(7.500)	15.000	0.34%
Total borrowing	**97.387**	**(8.150)**	**89.237**	
Long-term investments	9.642	0.000	9.642	5.79%
Short-term investments	3.300	(0.300)	3.000	0.22%
Cash and Cash equivalents	2.586	0.019	2.605	0.14%
Total Investments	**15.528**	**(0.281)**	**15.247**	
Net borrowing	**81.859**		**73.990**	

Appendix B

1. Debt Management

1.1 At 30 September 2017 Babergh held £86.547m of loans, a decrease of £6.25m on 31 March 2017. Mid Suffolk held £89.237m of loans, a decrease of £8.15m, due to income exceeding expenditure, which is the normal cash flow profile. These decreases reflect the changes for funding of the previous years' capital programmes. The borrowing position at 30 September 2017 is show in Table 3 below.

Table 3: Borrowing Position at 30th September 2017

Babergh	**31.3.17 Balance £m**	**Movement £m**	**30.9.17 Balance £m**	**30.9.17 Weighted Average Rate %**	**30.9.17 Weighted Average Maturity years**
Public Works Loan Board	86.797	(0.250)	86.547	3.21%	15.54
Local authorities (short term)	6.000	(6.000)	0.000	0.43%	0
Total borrowing	**92.797**	**(6.250)**	**86.547**		

Mid Suffolk	**31.3.17 Balance £m**	**Movement £m**	**30.9.17 Balance £m**	**30.9.17 Weighted Average Rate %**	**30.9.17 Weighted Average Maturity years**
Public Works Loan Board	70.887	(0.650)	70.237	3.52%	19.30
Banks (LOBO)	4.000	0.000	4.000	4.21%	60.92
Local authorities (short term)	22.500	(7.500)	15.000	0.34%	0.06
Total borrowing	**97.387**	**(8.150)**	**89.237**		

1.2 The Councils 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 being a secondary objective.

1.3 All new loans for Babergh and Mid Suffolk were taken as short term local authority borrowing to take advantage of low interest rates during the first half of 2017/18. This strategy enabled the Councils to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The "cost of carry" analysis performed by the Councils treasury management advisor Arlingclose did not indicate any value in borrowing in advance for future years' planned expenditure and therefore none was taken.

1.4 Mid Suffolk continues to hold £4million of LOBO loans (Lender's Option Borrower's Option) 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. The bank did not exercise their option in the first half of 2017/18.

Appendix C

1. Investment Activity

1.1 At 30 September, the Councils held £15.312m and £15.247m invested funds respectively, representing income received in advance of expenditure plus balances and reserves held.

1.2 During the first half of 2017/18 the Councils investment balances ranged between £12.457m and £21.156m for Babergh, and between £12.068m and £22.556m for Mid Suffolk, due to timing differences between income and expenditure.

The investment position during the half year is shown in Table 4 below.

Table 4: Investment Position

Babergh	**31.3.17 Balance £m**	**Movement £m**	**30.9.17 Balance £m**	**30.9.17 Weighted Average Rate %**
Banks and Building Societies	1.389	(0.515)	0.874	0.15%
Government	2.000	(2.000)	0.000	0.10%
Money Market Funds	2.700	2.100	4.800	0.18%
Other Pooled Funds	9.638	0.000	9.638	5.80%
Total Investments	**15.727**	**(0.415)**	**15.312**	

Mid Suffolk	**31.3.17 Balance £m**	**Movement £m**	**30.9.17 Balance £m**	**30.9.17 Weighted Average Rate %**
Banks and Building Societies	0.586	2.019	2.605	0.15%
Government	2.000	(2.000)	0.000	0.10%
Money Market Funds	3.300	(0.300)	3.000	0.22%
Other Pooled Funds	9.642	0.000	9.642	5.79%
Total Investments	**15.528**	**(0.281)**	**15.247**	

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 their investments before seeking the highest rate of return, or yield. The Councils objectives 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 Babergh and Mid Suffolk have both followed the approved treasury strategy and maintained investment in long term pooled funds. These funds have generated higher returns for the Councils in a period when interest rates are falling. The remaining investments are short term and highly liquid to ensure both Councils can meet their liabilities.

1.5 As a result, investment risk was diversified while the average rate of return has increased from 3.69% to 4.69% for Babergh and from 3.50% to 4.93% for Mid Suffolk over the 6-month period to 30th September 2017. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking

Babergh	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return
31.03.2017	4.81	A+	61%	71	3.69%
30.06.2017	5.53	A	88%	61	4.78%
30.09.2017	5.29	A+	90%	61	4.69%
Similar LAs	4.39	AA-	65%	108	1.43%
All LAs	4.44	AA-	64%	40	1.12%

Mid Suffolk	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return
31.03.2017	4.63	A+	59%	66	3.50%
30.06.2017	5.29	A+	88%	63	4.87%
30.09.2017	5.25	A+	90%	62	4.93%
Similar LAs	4.39	AA-	65%	108	1.43%
All LAs	4.44	AA-	64%	40	1.12%

1.6 Babergh has £9.638m of externally managed pooled equity, property and multi asset funds which generated an average total income return of £722k (5.8%) which is used to support service provision.

1.7 Mid Suffolk has £9.642m of externally managed pooled equity, property and multi asset funds which generated an average total income return of £576k (5.79%), which is used to support service provision.

1.8 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.

Appendix C

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 valuation available and details of interest received.

Table 6: Pooled Funds

Fund	Babergh	Mid Suffolk
	£	£
CCLA		
Amount invested	5,000,000	5,000,000
Value at 30.6.2017	4,815,884	4,741,395
Movement	**(184,116)**	**(258,605)**
Interest earned to 30.6.2017	464,347	411,187
Average return	5.07%	4.93%

UBS		
Amount invested	2,000,000	2,000,000
Value at 30.6.2017 BDC; 25.8.2017 MSDC	2,015,736	2,012,566
Movement	**15,736**	**12,566**
Interest earned to 30.6.2017	136,507	40,448
Average return	3.90%	4.04%

Schroders		
Amount invested	2,000,000	2,000,000
Value at 5.4.2017	1,975,408	1,975,408
Movement	**(24,592)**	**(24,592)**
Interest earned to 30.5.2017	82,610	82,610
Average return	8.26%	8.26%

Funding Circle		
Amount invested	638,000	642,000
Value at 4.10.2017	627,615	632,572
Movement	**(10,385)**	**(9,428)**
Interest earned to 30.6.2017	38,220	41,807
Average return	3.59%	3.90%

Total Pooled Funds		
Amount invested	9,638,000	9,642,000
Values	9,434,644	9,361,942
Movement	**(203,357)**	**(280,058)**
Interest earned	721,683	576,051
Average return	5.39%	5.37%

2.2 The two councils invested in CCLA on different dates (Babergh on 31 August 2015 and Mid Suffolk on 31 October 2015), so each purchased a different number of units. This is reflected in the latest values of the investments.

2.3 Both councils invested in Schroders Income Maximiser Fund on 6 February 2017 and the first returns, in April 2017, included a valuation (equalisation) adjustment.

2.4 The performance of the Funding Circle has not met initial expectations either financially or in the support of local businesses.

2.5 Average returns have fallen from 8.92% to 3.59% for Babergh and from 8.86% to 3.90% for Mid Suffolk since December 2015, mainly due to bad debts not recovered.

2.6 The initial investment was intended to go to support local businesses, but take up has been much lower than anticipated and most loans have been allocated to the National, rather than the Local account.

2.7 Since the initial investment into Funding Circle, the system for bidding for allocations has changed. The original method was a manual allocation of funds based on areas of business and credit ratings of the Councils choosing.

2.8 Two new options for automatic bidding have been introduced. One retains the same level of risk as present (A to A+) but with lower returns, expected to be in the range of only 3-4%. The other is investing in potentially lower credit rated, higher risk businesses (A to E) with higher returns (estimated at 7%). In both options, the Councils would not be able to choose where funds are allocated.

2.9 Both options expose the Councils to loss of control, higher risk to retain the same level of returns or the same risk level for reduced returns. None of these fit the Councils' investment strategy.

2.10 Continued membership of the Funding Circle is now under review. It is anticipated that as the current outstanding loans are paid off there will be no further reinvestment into the funds. Alternative solutions will be investigated.

3. Other Investment Activity

3.1 On 5 August 2016 Babergh purchased Borehamgate Shopping centre in Sudbury for £3.56million. This has been classified as an investment property and on 31 March 2017, the District Valuer assessed its Fair Value at £4million.

3.2 Net Income, after deducting direct costs, was £143k in 2016/17 and for the first half year of 2017/18 is £134k.

3.3 If CIPFA's proposed amendments to the Treasury Management Code are adopted in the revised Code from 2018/19, investment properties will henceforth be included in the expanded definition of "investments".

Appendix D

1. Treasury Management Indicators

1.1 The Section 151 Officer is pleased to report that, except for one occasion for Babergh, all treasury management activities undertaken during the first half of 2017/18 complied fully with the CIPFA Code of Practice and the Councils approved Treasury Management Strategy. Babergh exceeded their daily bank account limit with Lloyds by £120k for one day. Compliance with specific investment limits is demonstrated in Table 7 below.

Table 7: Investment Limits

Babergh	**Actual Maximum**	**30.9.17 Actual**	**2017/18 Limit**	**Complied**
Lloyds Bank	£2.12m	£874k	£2m	x
Money market funds	45%	31%	50%	✓
DMADF	£2m	Nil	No limit	✓
CCLA	£5m	£5m	£5m	✓
UBS	£2m	£2m	£5m	✓
Schroder	£2m	£2m	£5m	✓
Funding Circle	£638k	£638k	£1m	✓

Mid Suffolk	**Actual Maximum**	**30.9.17 Actual**	**2017/18 Limit**	**Complied**
Lloyds Bank	£899k	£855k	£1m	✓
Barclays Bank	£1m	£1m	£1m	✓
Svenska Handelsbanken	£750k	£750k	£1m	✓
Money market funds	36%	19.68%	50%	✓
DMADF	£6.5m	Nil	No limit	✓
CCLA	£5m	£5m	£5m	✓
UBS	£2m	£2m	£5m	✓
Schroder	£2m	£2m	£5m	✓
Funding Circle	£642k	£642k	£1m	✓

1.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in Table 8 below.

Table 8: Debt Limits

Borrowing	**Actual Maximum**	**30.9.17 Actual**	**2017/18 Operational Boundary**	**2017/18 Authorised Limit**	**Complied**
Babergh	£92.797m	£86.547m	£123m	£126m	✓
Mid Suffolk	£100.387m	£89.237m	£127m	£130m	✓

1.3 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.

2. Exposure to Treasury Management Risk

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

2.2 **Security:** The Councils have adopted a voluntary measure of their exposure to credit risk by monitoring the value-weighted average credit score of their investment portfolio. 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	**30.9.17 Actual**	**2017/18 Target**	**Complied**
Babergh	5.29	7.0	✓
Mid Suffolk	5.25	7.0	✓

2.3 **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	**30.9.17 Actual**	**2017/18 Target**	**Complied**
Upper limit on fixed interest rate exposure	£86.547m	£123m	✓
Upper limit on Variable interest rate exposure	(£15.312m)	£35m	✓

Mid Suffolk	**30.9.17 Actual**	**2017/18 Target**	**Complied**
Upper limit on fixed interest rate exposure	£74.237m	£127m	✓
Upper limit on Variable interest rate exposure	(£247k)	£40m	✓

2.4 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.

2.5 **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 fixed rate borrowing were:

Babergh	**30.9.17 Actual**	**Lower Limit**	**Upper Limit**	**Complied**
Under 12 months	0.00%	0	50%	✓
12 months and within 24 months	0.00%	0	50%	✓
24 months and within 5 years	2.08%	0	50%	✓
5 years and within 10 years	13.87%	0	100%	✓
10 years and within 20 years	82.78%	0	100%	✓
20 years and within 30 years	0.00%	0	100%	✓
30 years and above	1.27%	0	100%	✓

Mid Suffolk	**30.9.17 Actual**	**Lower Limit**	**Upper Limit**	**Complied**
Under 12 months	0.00%	0	50%	✓
12 months and within 24 months	0.00%	0	50%	✓
24 months and within 5 years	1.62%	0	50%	✓
5 years and within 10 years	20.21%	0	100%	✓
10 years and within 20 years	40.41%	0	100%	✓
20 years and within 30 years	21.16%	0	100%	✓
30 years and above	16.61%	0	100%	✓

2.6 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.

2.7 **Principal Sums Invested for Periods Longer than 364 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	**2017/18**	**2018/19**	**2019/20**
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

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.
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.

Appendix E

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.