Appendix 1 - Treasury Management Outturn Report 2018/19

Introduction

The Authority has 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 Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2018/19 was approved at a full Council meeting on 26 February 2018. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Authority's treasury management strategy.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year and, as a minimum, a semi-annual and annual treasury outturn report. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 25 February 2019.

External Context (provided by the Council's treasury management advisor, Arlingclose)

Economic background: After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

With the 29th March 2019, the original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, including shooting down Theresa May's deal for the third time, MPs voted by a majority of one (313 to 312) to force the prime minister to ask for an extension to the Brexit process beyond 12th April in order to avoid a no-deal scenario. Recent talks between the Conservative and Labour parties to try to reach common ground on a deal which may pass a vote by MPs have yet to yield any positive results. The EU must grant any extension and its leaders have been clear that the terms of the deal are not up for further negotiation. The ongoing uncertainty continues to weigh on sterling and UK markets.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

Financial markets: December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

Credit background: Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

Local Context

On 31st March 2018, the Authority had net borrowing of £365.4m and £45.9m of investments. 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: Balance Sheet Summary

	31.3.18 Actual £m
General Fund CFR	343.3
HRA CFR	248.7
Total CFR	**591.9**
Less: *Other debt liabilities	-34.0
Borrowing CFR - comprised of:	**557.9**

- External borrowing	365.4
- Internal borrowing	192.6

* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

The treasury management position at 31st March 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.18 Balance £m	Movement £m	31.03.19 Balance £m	31.03.19 Rate %
Long-term borrowing	307.4	58.4	365.8	4.14
Short-term borrowing	58.0	-35.0	23.0	0.90
Total borrowing	**365.4**	**23.4**	**388.8**	**3.95**
Long-term investments	0.0	0.0	0.0	0.00
Short-term investments	10.0	5.0	15.0	1.04
Cash and cash equivalents	35.9	-20.3	15.6	0.50
Total investments	**45.9**	**-15.3**	**30.6**	**0.77**
Net borrowing	**319.4**		**358.1**	

Borrowing Strategy during the year

At 31st March 2019 the Authority held £388.8m of loans, (an increase of £23.4m from 31st March 2018), as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 31st March are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.18 Balance £m	Net Movement £m	31.03.19 Balance £m	31.03.19 Weighted Average Rate %	31.03.19 Weighted Average Maturity (years)
Public Works Loan Board	182.4	58.4	240.8	3.84	27.39
Banks (LOBO)	125.0	0.0	125.0	4.72	41.19
Banks (fixed-term)	0.0	0.0	0.0	0.00	0
Local authorities (long-term)	0.0	0.0	0.0	0.00	0
Local authorities (short-term)	58.0	-35.0	23.0	0.90	0.11
Total borrowing	**365.4**	**23.4**	**388.8**	**3.95**	**30.21**

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

As the Authority has an increasing CFR due to the capital programme and an estimated borrowing requirement, the Authority expected to carry out additional long term borrowing in 2018/19, and raised £70m of long term fixed rate loans from the PWLB in the year, at an average rate of 2.57% which will provide longer-term certainty and stability to the debt portfolio. This borrowing was taken to fund the Council's growing underlying need to borrow from the capital programme, in conjunction with considerations around interest rates.

Going forwards into future years, the Council has a significant capital programme, and a large proportion of this will be financed by borrowing, which the Council will have to undertake in coming years. The Council's treasury advisor, Arlingclose undertakes weekly 'cost of carry' analysis to inform the Council about whether it is financially beneficial to undertake borrowing now or to delay this for set time periods: given PWLB interest rate forecasts. Any borrowing which is taken to prior to capital expenditure taking place, and reducing the extent of the Council's internal borrowing, would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing, creating an immediate cost for revenue budgets.

LOBO loans: The Authority continues to hold £125m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority 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 period.
The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

Treasury Investment Activity

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the year, the Authority's investment balances ranged between £11.2m and £88.6m million due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.03.18 Balance £m	Net Movement £m	31.03.19 Balance £m	31.03.19 Rate of Return %	31.03.19 Weighted Average Maturity days
Banks & building societies (unsecured)	0.0	0.0	0.0	0.00	0.0
Money Market Funds	0.0	0.0	0.0	0.00	0.0
UK Government:					
- Local Authorities	10.0	5.0	15.0	1.04	244.0
- Debt Management Office	35.9	-20.3	15.6	0.50	1.0
Total investments	**45.9**	**-15.3**	**30.6**	**0.77**	**120.1**

Both the CIPFA Code and government guidance require the Authority to invest its 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The table below shows counterparty credit quality as measured by credit ratings on the final day of each quarter during the year. The table also shows the percentage of the in-house investment portfolio exposed to bail-in risk. Bail-in is the response to the government bail-outs in the global financial crisis, when a number of banks failed and received government bail-outs in 2008. Under bail-in, unsecured deposits made with certain financial institutions would be at risk, should the institution fail, and investors would lose a portion of their invested funds. The below table shows a snapshot at a point in time, and movements in the figures do not reflect changes in policy or strategy, but are indicative of the Council's cashflows on that particular date.

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 – Treasury investments managed in-house

	Credit Score	**Credit Rating**	**Bail-in Exposure**	**Weighted Average Maturity (days)**	**Rate of Return %**
31.03.2018 Haringey	3.14	AA	0%	70	0.36
31.03.2019					
Haringey	3.37	AA	0%	122	0.77
Similar LAs	4.34	AA-	47%	166	1.25
All LAs	4.20	AA-	55%	53	1.43

Scoring:
-AAA = highest credit quality = 1
- D = lowest credit quality = 26
-Aim = A- or higher credit rating, with a score of 7 or lower, to reflect current investment approach with main focus on security

Non-Treasury Investments

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

The Council lends money to third parties such as its subsidiaries, local businesses, local charities, local residents and its employees to support local public services and stimulate local economic growth. These are often treated as capital expenditure and included within the Council's capital programme. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, it will be ensured that any new loans made will remain proportionate to the size of the Authority. The Council also holds properties which are classified as 'investment properties' in the Council's statement of accounts. These properties are all within the local area, and the revenue stream associated with these (net of the costs of maintaining the properties) forms a modest part of the Council's annual budget, therefore contributing to the resources available to the Council to spend on local public services.

Balances as at 31.3.19 of non-treasury investments were as follows:

Table 6: Non Treasury investments

	31.03.19				
	Balance £m	Loss Allowance £m	Balance £m	Weighted Average Rate of return %	Net Total Revenue* £m
Subsidiaries	0.3	-0.3	0.0	0.0	0.0
Local Businesses	4.8	-0.6	4.2	5.2	0.2
Local Charities	47.4	-43.5	3.9	3.3	0.1
Local Residents	0.1	0.0	0.1	4.4	0.0
Employees	0.1	0.0	0.1	0.0	0.0
Commercial Properties	70.5	0.0	70.5	5.8	4.1
Total borrowing	**123.2**	**-44.4**	**78.8**		**4.5**

*for commercial properties this is the revenue generated from the properties less directly associated costs

The largest balance above relates to Alexandra Palace debts (shown under local charities). There is a large amount of historic debt that a provision was created for, however this has not been written off. The loans to local business include the opportunity investment fund, and a loan to a business who operates some of Haringey's leisure facilities.

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts for 2018/19 onwards are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

The Authority assesses the risk of loss before entering into and whilst holding service loans by weighing up the service outcomes any such loan could provide against the creditworthiness of the recipient. This is done on a case by case basis, given the low number of such arrangements. This forms part of the Council's capital programme, further details of which are in the Council's annual medium term financial strategy.

Budgeted Income and Outturn

Treasury Investments generated an average rate of return of 0.66% in the first three quarters of the year. The Council's treasury investment income for the year was £317k against a budget of £136.5k.

Borrowing costs for 2018/19 were £14.6m (£10.3m HRA, £4.3m General Fund) against a budget of £15.7m (£10.0m HRA, £5.7m General Fund). The underspend forecast is due to a number of factors, including: the current lower interest rate environment reducing interest costs for the Council, and delays in the capital programme's delivery. Slippage in the Council's capital programme will reduce the borrowing requirement, and reduce this forecast.

Compliance

The Director of Finance reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

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

Table 7: Debt Limits

	31.3.19 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied?
Borrowing	388.8	568.4	618.4	Yes
PFI and Finance Leases	36.2	39.9	43.3	Yes
Total debt	**424.9**	**608.3**	**661.6**	Yes

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, however Haringey's debt remained below this limit at all points in the financial year.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its 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.

	31.3.19 Actual	2018/19 Target	Complied?
Portfolio average credit	3.14 (AA)	7.00 (A-)	Yes

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	31.3.19 Actual	2018/19 Target	Complied?
Total cash available within 3 months	£20.6	£10m	Yes

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

	31.3.19 Actual	2018/19 Limit	Complied?
Upper limit on fixed interest rate exposure	72.6%	100%	Yes
Upper limit on variable interest rate exposure	27.4%	60%	Yes

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.

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

Maturity structure of borrowing (U: upper, L: lower)	Lower Limit	Upper Limit	31.3.19
under 12 months	0	60%	27.4%
12 months & within 2 years	0	40%	1.7%
2 years & within 5 years	0	40%	20.5%
5 years & within 10 years	0	40%	0.6%
10 yrs & within 20 yrs	0	40%	8.3%
20 yrs & within 30 yrs	0	40%	10.3%
30 yrs & within 40 yrs	0	50%	15.9%
40 yrs & within 50 yrs	0	50%	15.4%
50 yrs & above	0	40%	0

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.

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

	2018/19	2019/20	2019/21
Actual principal invested beyond year end	-	-	-
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes