Report for: Corporate Committee 20 September 2018

Item number: 9

Title: Treasury Management Update Report

Report authorised by: Jon Warlow, Director of Finance (S151 Officer)

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Ward(s) affected: N/A

Report for Key/ Non Key Decision: Non Key decision

1. Describe the issue under consideration

1.1. This report updates the Committee on the Council's treasury management activities and performance in the three months to 30th June 2018 in accordance with the CIPFA Treasury Management Code of Practice.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. That members note the Treasury Management activity undertaken during the three months to 30th June 2018 and the performance achieved.

3.2. That members note that all treasury activities were undertaken in line with the approved Treasury Management Strategy: in particular the prudential indicators with fixed limits shown in appendix 1.

4. Reason for Decision

4.1. None.

5. Other options considered

5.1. None.

6. Background information

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6.1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement. CIPFA has defined Treasury management as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

6.2. The Code recommends that members are informed of treasury management activities at least twice a year. Formulation of treasury policy, strategy and activity is delegated to the Corporate Committee and this Committee receives reports quarterly.

6.3. However, overall responsibility for treasury management remains with full Council and the Council approved the Treasury Management Strategy Statement and set the Prudential Indicators for 2018/19 on 26 February 2018. The Corporate Committee is responsible for monitoring treasury management activity and this is achieved through the receipt of quarterly reports. This report forms the 1st quarterly monitoring report for 2018/19.

6.4. Government guidance on local authority treasury management states that local authorities should consider the following factors in the order they are stated:

Security - Liquidity - Yield

The Treasury Management Strategy reflects these factors and is explicit that the priority for the Council is the security of its funds. However, no treasury activity is without risk and the effective identification and management of risk are integral to the Council's treasury management activities.

7. Contribution to Strategic Outcomes

7.1. None.

8. Statutory Officers comments (Chief Finance Officer (including procurement), Assistant Director of Corporate Governance, Equalities)

Finance and Procurement

8.1. Interest rates earned on investments remain low and significantly less than the cost of new borrowing and therefore the strategy of keeping cash balances low is continuing in 2018/19. Borrowing is usually taken when required for liquidity purposes with the default being for short term local authority loans at very low rates, however some longer term borrowing will be taken during the year at points when interest rates fall to opportunely low levels.

Legal

8.2. The contents and recommendation of this report are in accordance the Treasury Management Strategy Statement and consistent with legislation governing the financial affairs of the Council. In considering the report Members must take into account the expert financial advice available to it and any further oral advice given at the meeting of the Committee.

Equalities

8.3. There are no equalities issues arising from this report.

9. Use of Appendices

Appendix 1 – Prudential and Treasury Indicators

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.

11. External Context: Economic Commentary and Outlook (from Haringey's Treasury Advisor, Arlingclose)

11.1. **Economic background:** Commodity prices fell during the quarter, although oil prices rose, peaking at $75 a barrel before falling slightly to just over $73. The primary factor in the oil price's recent fall was the OPEC's (Organisation of Petroleum Exporting Countries) announcement that a deal had been reached with non-OPEC nations to increase nominal production by 1 million barrels a day.

11.2. UK Consumer Price Inflation (CPI) index fell over the quarter and the data released for May showed CPI at 2.4%, a 12-month low. The most recent labour market data for April 2018 showed the unemployment rate at 4.2%, a low last seen in 1975. However real wages (i.e. adjusted for inflation) grew only by 0.4%, a marginal increase unlikely to have had much effect for households. Q1 GDP data released in April and revised in May showed economic activity slowing to 0.2%. 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 have raised expectations of a rate hike at the August meeting *(the bank rate was subsequently raised in August)*.

11.3. Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in June by 0.25% to between 1.75% and 2% and markets now expect two further rises in 2018.

11.4. Fears rose of a global trade war on the announcement of the Trump Administration implementing tariffs on $200bn of imports, notably steel, aluminium, food and chemicals. Canada, the EU and China contemplated announced retaliatory tariffs as did Mexico. Many of these have since been instituted in early July. The announcements sparked a sell-off in global equity markets, with the major equity global indices falling.

11.5. 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 a vote of 319 to 303, after the government gave assurances that Parliament would have a meaningful vote in the event of a no-deal Brexit. Very little progress was made in negotiating future trading arrangements, extending the period of uncertainty.

11.6. **Financial markets:** Gilt yields displayed marked volatility during the quarter, 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. The yield on the 5-year benchmark gilt fell from 1.13% to 1.04% during the quarter, the 10-year gilt fell from 1.36% to 1.28% and the yield on the 20-year gilt rose marginally from 1.71% to 1.72%. Money markets rates remained low: 1-month, 3-month and 12-month LIBID rates averaged 0.38%, 0.55% and 0.84% in the quarter respectively.

11.7. **Credit background**: UK bank credit default swaps rose marginally over the quarter, but the overall level was still low against historic averages.

11.8. There were a few credit rating changes during the quarter. Moody's downgraded Barclays Bank Plc's long-term rating to A2 from A1 after the banking group completed its restructure to be compliant with UK bank ring-fencing requirements which come into effect in 2019. The agency also downgraded Royal Bank of Scotland plc's (RBS plc) long-term ratings to Baa2 from A3 on its view that the credit metrics of RBS plc, which will become the non-ring-fenced NatWest Markets plc, will become weaker and less diversified and the main functions of the bank would be in higher risk activities. Moody's and Fitch upgraded the long-term ratings of NatWest Bank and Ulster Bank on the view that their credit profiles are expected to improve following ring-fencing.

12. Local Context

12.1. At 31/3/2018 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £591.9m. The Council had £365.4m of borrowing and £45.9m of investments. The difference represents timing differences in cash received and paid, internal borrowing, i.e. the use of cash which represents reserves and balances rather than the externalising of debt, and the use of lease-type arrangements for the acquisition of assets.

12.2. The Council's current strategy is to maintain actual borrowing levels below the Capital Financing Requirement (CFR), this is referred to as internal borrowing.

12.3. The Council has an increasing CFR over the next 3 years due to the capital programme, but minimal investments which can be used to fund capital plan cashflows. The Council will therefore need to take out additional borrowing over the forecast 3 year period.

13. Borrowing Strategy During the Quarter

13.1. At 30/06/2018 the Council held £296.7m of long term loans, (a decrease of £10.7m on 31/3/2018). The Council expects to take out additional long term borrowing in 2018/19, as the Council's underlying need to borrow is growing. Interest rates are carefully monitored and advice is taken from the Council's treasury adviser Arlingclose in relation to this.

13.2. The Council has a significant capital programme, and a significant 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 prior to capital expenditure taking place 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.

13.3. The Council will consider undertaking borrowing in the current year and meet the cost of carry until future years' capital expenditure takes place, if this is affordable, prudent, and if there is intelligence that PWLB borrowing rates may to rise significantly. This would reduce the extent of the Council's internal borrowing.

13.4. A significant 'known unknown' in future forecasting is the impact of Brexit, which may impact adversely on gilts, and therefore PWLB rates. The risk management of our treasury position to this uncertainty is being monitored closely by the Council's treasury advisor Arlingclose, and officers.

<u>Borrowing Activity</u>

Borrowing	Balance at 1 Apr 2018 £'000	Borrowing Raised £'000	Maturities £'000	Balance at 30 June 2018 £'000	Avg Rate %
Short term Borrowing					
- UK Local Authorities	58,000	43,000	81,000	20,000	0.44
Long Term Borrowing					
- PWLB	182,381	0	10,651	171,730	4.34
- LOBO	125,000	0	0	125,000	4.72
TOTAL BORROWING	365,381	43,000	91,651	316,730	4.24

13.5. **LOBOs:** The Council holds £125m 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. £100m of these LOBOS had options during the quarter, none of which were exercised by the lenders. There is still however a refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

14. Investment Activities

14.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Cashflow forecasts indicated that during 2018/19 the Council's investment balances would range between £10 and £50 million. Average investment balances were £29.9m in the first quarter of the year.

14.2. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles

14.3. The Council has sought to minimise its security risk by setting limits on each institution on the lending list. The Council has complied with all these limits during the financial year to date.

14.4. The economic environment remains uncertain, and given this background, the Council has kept cash investments to a minimum and short term. Money Market Funds continue to be used extensively as the portfolios are spread across a range of underlying investments to diversify risk. They also provide instant access enabling officers to take action quickly if there are any concerns about creditworthiness. The remainder of the Council's investments are held with the DMO (government agency).

<u>Investment Activity</u>

Investments	Balance at 1 Apr 2018 £'000	Investments Made £'000	Maturities £'000	Balance at 30 June 2018 £'000	Avg Rate /Yield %
Short term Investments (call accounts, depos					
- Banks & Building Societies	0	0	0	0	-
UK Government:					
- Deposits at Debt Management Office	35,945	127,360	163,305	0	-
- UK Local Authorities	10,000	0	0	10,000	0.75
Money Market Funds	0	104,535	97,085	7,450	0.50
TOTAL INVESTMENTS	45,945	231,895	260,390	17,450	0.64

*The balances shown above represent a snapshot on a particular day, balances can move significantly from day to day dependent on the Council's cashflows at a point in time.

Credit Risk

14.5. 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.

Date	Value Weighted Average - Credit Risk Score	Value Weighted Average - Credit Rating	Time Weighted Average - Credit Risk Score	Time Weighted Average - Credit Rating	Investments exposed to bail-in risk
					%
31/03/2018	3.14	AA	3.60	AA-	0
30/06/2018	4.26	AA-	3.63	AA-	43

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-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

Budgeted Income and Outturn

14.6. The UK Bank Rate had been maintained at 0.50% across the quarter. Short-term money market rates have remained at relatively low levels, however have risen gradually following the rate increase in November 2017 .

14.7. Treasury Investments generated an average rate of return of 0.55% in the quarter. The Council's forecast investment income for the year is estimated at £152.0k against a budget of £136.5k.

14.8. Borrowing costs for 2018/19 are forecast at £14.8m (£10.3m HRA, £4.5m General Fund) against a budget of £15.7m (£10.0m HRA, £4.5m 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.

15. Compliance with Prudential Indicators

15.1. The Council confirms compliance with its Prudential Indicators for 2018/19, which was set in February 2018 as part of the Council's Treasury Management Strategy Statement.

Treasury Management Indicator

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

15.3. **Interest Rate Exposures**: This indicator is set to control the Council'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 will be:

	2018/19 Q1	**2018/19 Full Year**	**2019/20**
Upper limit on fixed interest rate exposure	100%	100%	100%
Actual	93%		
Upper limit on variable interest rate exposure	60%	60%	60%
Actual	7%		

15.4. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate, including short term borrowings.

15.5. **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**30-Jun-18**
under 12 months	0%	60%	6.6%
12 months & within 2 years	0%	40%	2.7%
2 years & within 5 years	0%	40%	6.2%
5 years & within 10 years	0%	40%	6.0%
10 yrs & within 20 yrs	0%	40%	7.0%
20 yrs & within 30 yrs	0%	40%	15.8%
30 yrs & within 40 yrs	0%	50%	29.0%
40 yrs & within 50 yrs	0%	50%	26.7%
50 yrs & above	0%	40%	0.0%

15.6. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

15.7. **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. Given the policy of spending down cash balances and use of internal borrowing the Council does not expect to invest beyond 364 days in the medium term.

16. Outlook for the remainder of 2018/19 (from Haringey's Treasury Advisor, Arlingclose)

16.1. The MPC has maintained expectations of a rise in interest rates this year. Arlingclose's central case is for Bank Rate is to rise once in 2018 and twice more in 2019. The MPC has a definite bias towards tighter monetary policy. While policymakers are wary of domestic inflationary pressures over the next two years, it is believed that the MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and that 2) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise. *(The rate rise forecast in the quarter to September 2018 did occur in August 2018)*

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

16.2. Arlingclose's 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.

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Appendix 1: Prudential Indicators

No.	Prudential Indicator	2018/19 Original Indicator	2018/19 Forecast Position 30 June
CAPITAL INDICATORS			
1	Capital Expenditure	£'000	£'000
	General Fund	143,119	114,495
	HRA	58,850	47,080
	TOTAL	201,969	161,575

2	Ratio of financing costs to net revenue stream	%	%
	General Fund	2.48	1.84
	HRA	9.87	9.49

3	Capital Financing Requirement	£'000	£'000
	General Fund	413,279	399,284
	HRA	275,087	269,804
	TOTAL	688,366	669,088

4	Incremental impact of capital investment decisions	£	£
	Band D Council Tax	35.03	28.85
	Weekly Housing rents	2.16	0.35

5	Borrowing Limits	£'000	£'000
	Authorised Limit / actual debt	661,627	316,730
	Operational Boundary/actual debt	608,300	316,730

No.	Prudential Indicator	2018/19 Original Indicator	30-Jun-18

6	HRA Debt Cap	£'000	£'000
	Headroom	52,451	64,221

7	Gross debt compared to CFR	£'000	£'000
	Gross debt	365,381	316,730
	CFR	688,366	669,088

8	Upper limit – fixed rate exposure	100%	93.4%
	Upper limit – variable rate	60%	6.6%

9	Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**30-Jun-18**
	under 12 months	0%	60%	6.6%
	12 months & within 2 years	0%	40%	2.7%
	2 years & within 5 years	0%	40%	6.2%
	5 years & within 10 years	0%	40%	6.0%
	10 yrs & within 20 yrs	0%	40%	7.0%
	20 yrs & within 30 yrs	0%	40%	15.8%
	30 yrs & within 40 yrs	0%	50%	29.0%
	40 yrs & within 50 yrs	0%	50%	26.7%
	50 yrs & above	0%	40%	0.0%

10	Sums invested for > 364 days	£0	£0

11	Adoption of CIPFA Treasury Management Code of Practice	√	√

12	**LOBO Adjusted** Maturity structure of borrowing (U: upper, L: lower)	L	U	**30-Jun-18**
	under 12 months	0%	60%	30.3%
	12 months & within 2 years	0%	40%	18.5%
	2 years & within 5 years	0%	40%	6.2%
	5 years & within 10 years	0%	40%	6.0%
	10 yrs & within 20 yrs	0%	40%	7.0%
	20 yrs & within 30 yrs	0%	40%	12.6%
	30 yrs & within 40 yrs	0%	50%	16.4%
	40 yrs & within 50 yrs	0%	50%	3.1%
	50 yrs & above	0%	40%	0.0%