Report for: Corporate Committee 3 December 2018

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 six months to 30 September 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 six months to 30 September 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

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 2nd 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. As this report details a financial subject matter, finance comments are made throughout the content of this report.

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:** 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/year, above the consensus forecast and that of the Bank of England's 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.

11.2. 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/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 Bank Rate to 0.75%.

11.3. 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.

11.4. 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.

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 just six months to go when Article 50 expires on 29th 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 [at the time of writing], extending the period of economic uncertainty.

11.6. **Financial markets:** 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 net 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.

11.7. **Credit background**: 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.

11.8. 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.

11.9. 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.

11.10. Our 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 CDs but not senior unsecured bonds issued by commercial banks.

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 30/09/2018 the Council held £306.2m of long term loans, (a decrease of £1.2m on 31/3/2018). The Council expected to carry out additional long term borrowing in 2018/19, and outside of the reporting period of this report, £50m of additional long term borrowing was taken in the month of October at an average interest rate of 2.61%. 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.

13.2. Interest rates are carefully monitored and advice is taken from the Council's treasury adviser Arlingclose in relation to this regarding the precise timing of any borrowing.

13.3. 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 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.

13.4. The Council does not, at the time of writing, anticipate that any additional long term borrowing will be raised in 2018/19 due to the aforementioned borrowing transactions. However, the timing of new borrowing is somewhat dependent on the wider economic position of the UK. A significant 'known unknown' in future forecasting is the impact of Brexit, which may impact adversely on gilts, and therefore

PWLB rates. The Council will therefore consider undertaking borrowing in the current year to reduce the extent of the Council's internal borrowing, 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 is a matter that is under continual review by officers, and the Council's appointed treasury management advisor, Arlingclose.

<u>Borrowing Activity</u>

Borrowing	Balance at 1 Apr 2018 £'000	Borrowing Raised £'000	Maturities £'000	Balance at 30 Sept 2018 £'000	Avg Rate %
Short term Borrowing					
- UK Local Authorities	58,000	69,000	114,000	13,000	0.93
Long Term Borrowing					
- PWLB	182,381	10,000	11,135	181,246	4.25
- LOBO	125,000	0	0	125,000	4.72
TOTAL BORROWING	365,381	79,000	125,135	319,246	4.30

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. None of these LOBOS had options during the quarter. 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 generally range between £10 and £50 million. Average investment balances were £28.4m in the first two quarters of the year. The average investment balance will be increased for the remainder of the financial year due to the borrowing undertaken in October, as mentioned above, reflecting the higher level of Council balances being invested externally.

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).

Investment Activity

Investments	Balance at 1 Apr 2018 £'000	Investments Made £'000	Maturities £'000	Balance at 30 Sept 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	354,165	390,110	0	-
- UK Local Authorities	10,000	0	0	10,000	0.75
Money Market Funds	0	226,510	218,920	7,590	0.67
TOTAL INVESTMENTS	45,945	580,675	609,030	17,590	0.71

*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
30/09/2018	4.18	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 was raised by 0.25% to 0.75% during the quarter. Short-term money market rates have remained at relatively low levels, however have risen gradually following this and the previous rate rise in November 2017.

14.7. Treasury Investments generated an average rate of return of 0.60% in the first two quarters of the year. The Council's forecast investment income for the year is estimated at £270k against a budget of £136.5k.

14.8. Borrowing costs for 2018/19 are forecast at £15.1m (£10.3m HRA, £4.8m 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.

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	96%		
Upper limit on variable interest rate exposure	60%	60%	60%
Actual	4%		

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-Sept-18
under 12 months	0%	60%	4.4%
12 months & within 2 years	0%	40%	2.5%
2 years & within 5 years	0%	40%	6.2%
5 years & within 10 years	0%	40%	5.9%
10 yrs & within 20 yrs	0%	40%	10.1%
20 yrs & within 30 yrs	0%	40%	15.7%
30 yrs & within 40 yrs	0%	50%	28.8%
40 yrs & within 50 yrs	0%	50%	26.5%
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. Having raised policy 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.

16.2. 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.

16.3. 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 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

16.4. 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.

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Appendix 1: Prudential Indicators

No.	Prudential Indicator	2018/19 Original Indicator	2018/19 Forecast Position 30 September
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	319,246
	Operational Boundary/actual debt	608,300	319,246

No.	Prudential Indicator	2018/19 Original Indicator		30-Sep-18
6	HRA Debt Cap	£'000		£'000
	Headroom	52,451		78,868
7	Gross debt compared to CFR	£'000		£'000
	Gross debt	365,381		319,246
	CFR	688,366		669,088
8	Upper limit – fixed rate exposure	100%		95.6%
	Upper limit – variable rate	60%		4.4%
9	Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**30-Sep-18**
	under 12 months	0%	60%	4.4%
	12 months & within 2 years	0%	40%	2.5%
	2 years & within 5 years	0%	40%	6.2%
	5 years & within 10 years	0%	40%	5.9%
	10 yrs & within 20 yrs	0%	40%	10.1%
	20 yrs & within 30 yrs	0%	40%	15.7%
	30 yrs & within 40 yrs	0%	50%	28.8%
	40 yrs & within 50 yrs	0%	50%	26.5%
	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-Sep-18**
	under 12 months	0%	60%	27.9%
	12 months & within 2 years	0%	40%	2.5%
	2 years & within 5 years	0%	40%	21.8%
	5 years & within 10 years	0%	40%	5.9%
	10 yrs & within 20 yrs	0%	40%	10.1%
	20 yrs & within 30 yrs	0%	40%	12.5%
	30 yrs & within 40 yrs	0%	50%	16.2%
	40 yrs & within 50 yrs	0%	50%	3.0%
	50 yrs & above	0%	40%	0.0%

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