Haringey Council Mid – Year Treasury Report 2015/16

Appendix 1

1. Introduction

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice yearly (mid-year and at year end). This report covers the six months to September 2015.

The Authority's Treasury Management Strategy for 2015/16 was approved by full Council on 23 February 2015.

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. This report covers treasury activity and the associated monitoring and control of risk.

2. External Context

As the year began, economic data was largely overshadowed by events in Greece. Markets' attention centered on the never-ending Greek issue, running the serious risk of a disorderly exit from the Euro. Following a July European Union Summit, it was announced that the terms for a third bailout of Greece had been reached, which was subsequently endorsed when the ruling party was returned to power in a snap election.

The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months on the back of concerns over growth. The People's Bank of China allowed an aggressive devaluation of the currency. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. On 24th August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

UK Economy: The economy has remained resilient over the last six months. First estimates of Q3 2015 GDP growth is 0.5%, with year/year growth showing slight signs of slowing, decreasing to 2.3%. GDP has now increased for eleven consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) turned negative in April, falling to -0.1%, before subsequently fluctuating between -0.1% and 0.1%. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections expect inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the ILO unemployment rate for the three months to September fall to 5.3%. In the October report, average earnings excluding bonuses for the three months to August rose 3.0% year/year.

US GDP increased 1.5 percent in the third quarter, after increasing 3.9 percent in the second. The deceleration in real GDP in the third quarter primarily reflected a downturn in private inventory investment and decelerations in exports, in non residential fixed investment and in state and local government spending. With the Fed's decision on US interest rate dependent upon data, GDP is providing mixed signals. The Fed is keen to see inflation rise alongside its headline economic growth and also its labour markets. The Committee decided not to act at its October meeting as many had been anticipating but it remains possible that rates will rise before the end of the year.

Market reaction: Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight. Indices have not recovered to their previous levels but some improvement has been seen. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Concerns around China saw bond yields dropping again through August and September. Bond markets were also distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory.

3 Local Context

At 31/3/2015 the Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £549 million, while usable reserves and working capital which are the underlying resources available for investment were £263m.

At 31/3/2015, the Authority had £342 million of borrowing and £35m of investments. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, subject to holding a sufficient cash balances to provide liquidity for day-to-day expenditure

The Authority has an increasing CFR over the next 3 years due to the capital programme, but minimal investments and will therefore is projected to borrow up to £99 million over the forecast period.

4 Borrowing Strategy

At 30/9/2015 the Authority held £289 million of loans, a decrease of £5 million on 31/3/2015), as part of its strategy for funding previous years' capital programmes. In addition there are PFI / leasing liabilities of £53 million.

The treasury strategy for 2015-16 projected an additional borrowing requirement of £43 million in the year to fund the capital programme. No additional debt has been required to date and it may be that delays to planned expenditure mean that any borrowing is significantly lower than was initially projected. Current capital plans estimate debt funded capital expenditure of £38 million in 2015-16.

The Authority's chief objective when borrowing continues to be striking 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.

Affordability and the "cost of carry" remained important influences on the Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the Authority determined it was more cost effective in the short-term to use internal resources and were necessary short-term local authority loans to provide liquidity.

The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Authority with this 'cost of carry' and breakeven analysis. Temporary and short-dated loans borrowed from the markets, predominantly from other local authorities, has remained affordable and attractive.

Borrowing Activity in 2015/16

	Balance on 01/04/2015 £m	Maturing Debt £m	Debt Prematurely Repaid £m	New Borrowing £m	Balance on 30/09/2015 £m	Avg Rate % and Avg Life (yrs)
CFR	549,387				N/A	
Short Term Borrowing[1]	0					
Long Term Borrowing	294,065	-5,325			288,740	30.2
TOTAL BORROWING	294,665	-5,325			288,740	
Other Long Term Liabilities	48,218				47,213	
TOTAL EXTERNAL DEBT	342,883				335,953	
Increase/ (Decrease) in Borrowing £m					-6,930	

PWLB Certainty Rate and Project Rate Update: The Authority qualifies for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12 month period from 01/11/2014. In April the Authority submitted its application to the CLG along with the 2015/16 Capital Estimates Return to access this reduced rate for a further 12 month period from 01/11/2015.

LOBOs: The Authority holds £125 million 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 Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS had options during the quarter, none of which were exercised by the lender. The Authority acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are unlikely to exercise their options.

Debt Rescheduling:

The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Authority's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

[1] Loans with maturities less than 1 year.

Changes in the debt portfolio over the quarter have achieved an annualised reduction in the overall debt cost of £447,000. The average rate of interest on debt fell marginally from 5.34% to 5.29% whilst there was a 0.1 year increase in the average life to 30.2 years.

5 Investment Activity

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Cashflow forecasts indicated that during 2015/16 the Authority's investment balances would range between £10 million and £77 million.

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

Investment Activity in 2015/16

Investments	Balance on 01/04/2015 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 30/09/2015 £m	Avg Rate/Yield (%) and Avg Life years)
Short term Investments (call accounts, deposits) - Banks and Building Societies with ratings of A- or higher - Local Authorities	6,840	87,935	-69,472	25,303	0.50%/ 31 days
Long term Investments - Banks and Building Societies with ratings of A- or higher - Local Authorities					
UK Government: - DMADF - Treasury Bills - Gilts	12,200	594,700	-606,900	0	
Money Market Funds	16,190	102,365	-96,055	22,500	0.38%/1 day
Other Pooled Funds *(VNAV funds)* Cash Plus funds		5,000		5,000	0.65%/4 days
TOTAL INVESTMENTS	35,230	790,000	-772,427	52,803	0.46%/16days
Increase/ (Decrease) in Investments £m				17,573	

Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16.

Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating is A- across rating agencies Fitch, S&P and

Moody's); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

The first investment into an enhanced cash fund was made in September; £5 million with the Insight Liquidity Plus Fund. This fund is AAA rated (same as money market funds), invests in similar types of securities and counterparties, but has a longer average maturity (60 days) compared with money market funds (49 days) and as a consequence a higher income yield of 0.96% compared with money market 0.43%.

Since the September 2015 we have made our first investments into tradable instruments buying £5 million of 3 month UK Government treasury bills yielding 0.43% (an improvement over the 0.25% DMO rate) and £3 million of Standard Chartered Bank 5 month CDs yielding 0.66%. These offer yield pick up with the ability to sell before maturity thereby enhancing liquidity.

6 Credit Risk

Counterparty credit quality as measured by credit ratings is summarised below:

Date	Value Weighted Average - Credit Risk Score	Value Weighted Average - Credit Rating	Time Weighted Average - Credit Risk Score	Time Weighted Average - Credit Rating
31/03/2015	3.57	AA-	2.70	AA
30/06/2015	4.39	AA-	5.60	A
31/10/2015	4.02	AA-	3.55	AA-
Target	3-5	AA to A+	3-5	AA to A+

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

The Council target score of 3-5 emphasises the desire to minimise credit risk. The maximum score compares with Arlingclose suggestion of 7 (equivalent to A-). The investment portfolio is within the target range at the end of October following the introduction of treasury bills and a Standard Chartered CD.

7 Counterparty Update

All three credit ratings agencies have reviewed their ratings in the six months to reflect the loss of government support for most financial institutions and the potential for varying loss given defaults as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

Changes in credit rating during the six months and subsequently impacting the Council's counterparty credit ratings are:

Fitch – upgraded Lloyds Banking Group from A to A+

Moody's – upgraded Standard Chartered to AA2 (from A+), HSBC to AA2 (from AA3), Coventry BS to A2 (from A3), Nationwide BS to A1 (from A2) and Svenska Handelsbanken to AA2 (from AA3).

S&P – downgraded downgrading Barclays to A- (from A).

Apart from Barclays, the changes in long term ratings have been positive. Barclays remains within our accepted minimum credit quality of A- and we continue to utilise for overnight (but not longer) deposits.

At the end of July, the council's treasury advisors Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. The Council has retained the maximum maturities set out in the strategy.

8 Budgeted Income and Outturn

The average cash balances were £65 million during the half year. The UK Bank Rate has been maintained at 0.5% since March 2009. Short-term money market rates have remained at relatively low levels. Investments earned an average rate of 0.42% (£136,000).

9 Update on Investments with Icelandic Banks

A further Heritable distribution of £792,000 was received during August, bringing total recoveries into the Council's bank account from the Icelandic banks of £35.6m out of the original £36.9m invested, which is a 96% recovery. Further distributions from Heritable (£0.3m outstanding) are likely. The Glitnir escrow account has a balance of approximately £0.4 million locked in an Icelandic Krona account due to exchange control restrictions, which will eventually be lifted allowing the funds to be converted to sterling. Eventual recoveries of 98% are estimated.

10 Compliance with Prudential Indicators

The Authority confirms compliance with its Prudential Indicators for 2015/16, which were set in 23 February 2015 as part of the Authority's Treasury Management Strategy Statement.

11 Treasury Management Indicators

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

12 Investment Training

Training was provided to members of the Corporate Committee and Overview & Scrutiny in January 2015.

Haringey Council Mid - Year Treasury Report 2015/16

Annex 1: Summary of Treasury Management Activity and Performance

1. Treasury Portfolio

	Position March 2015 £'000	Position September 2015 £'000
Long Term Borrowing PWLB	169,065	163,740
Long Term Borrowing Market	125,000	125,000
Short Term Borrowing		0
Total Borrowing	294,065	288,740
Investments: Council	35,230	52,803
Investments: Icelandic deposits in default	2,177	1,385
Total Investments	37,407	54,188
Net Borrowing position	256,658	234,552

3. Security measure

	March 2015	October 2015
Credit score - Value weighted	3.57	4.02
Credit score - Time weighted	4.95	3.55

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.

4. Liquidity measure

	March 2015	September 2015
Weighted average maturity - deposits (days)	1.9	16
Weighted average maturity - borrowing (years)	30.1	30.2

5. Yield measure

	March 2015	September 2015
Interest rate earned	0.36	0.46
Interest rate payable	5.33	5.29

Annex 2: Prudential Indicators

The Prudential indicators are designed to demonstrate the affordability of current and forecast borrowing. There is no 'correct' value in each table and the trend is at least as important as the absolute numbers. Debt is used to finance the capital programme and each decision to incur capital expenditure will consider how it is to be funded.

	Prudential Indicator	2015/16 Original Indicator	Forecast as at 30 Sept 2015
CAPITAL INDICATORS			
1	Capital Expenditure	£'000	£'000
	General Fund	54,568	54,568
	HRA	92,074	92,074
	TOTAL	146,642	146,642

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and in particular, to consider the impact on tax and housing rent levels. Capital expenditure projections remain in line with the strategy.

2	Ratio of financing costs to net revenue stream	2015/16 Original Indicator	Forecast as at 30 Sept 2015
	General Fund	1.90%	1.88%
	HRA	9.28%	9.02%

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income. The indicators show that interest costs have used a marginally lower proportion of council income than initially projected.

3	Capital Financing Requirement	2015/16 Original Indicator	Forecast as at 30 Sept 2015
	General Fund	297,121	290,651
	HRA	292,666	292,666
	TOTAL	589,787	583,317

The above is the maximum external borrowing requirement representing the remaining cost of capital expenditure. The out-turn is in line with the start of year projections.

4	Incremental impact of capital investment decisions	2015/16 Original Indicator	Forecast as at 30 Sept 2015
	Band D Council Tax	34.03	32.99
	Weekly Housing rents	2.27	2.11

This is an indicator of affordability and shows the impact of capital investment decisions on Council tax and housing rent levels. Both indicators are a little better than originally projected due to lower financing costs.

No.	Prudential Indicator	2015/16 Original Indicator	Position / forecast September 2015
5	Borrowing Limits	£k	£k
	Authorised Limit / actual debt	503,532	341,740
	Operational Boundary/actual debt	447,867	341,740
NB: the June position includes PFI & leases of £53.0m			

The operational boundary for external debt is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

6	HRA Debt Cap	£k	£k
	Headroom	44,235	44,235

HRA headroom is the capacity for additional debt funded HRA capital expenditure.

7	Gross debt compared to CFR	£k	£k
	Gross debt	342,283	343,047
	CFR	549,387	549,387

The Council is permitted to borrow for capital projects. The difference between CFR and gross debt is a measure of the use of internal borrowing to fund capital expenditure.

8	Upper limit – fixed rate exposure	100%	98%
	Upper limit – variable rate	40%	2%

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 principal borrowed. 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. Debt is almost entirely fixed rate which protects against the impact of changes in market rates.

9	Maturity structure of borrowing (U: upper, L: lower)	L	U	Mar-16
	under 12 months	0%	40%	4.7%
	12 months & within 2 years	0%	35%	8.0%
	2 years & within 5 years	0%	35%	6.7%
	5 years & within 10 years	0%	35%	11.1%
	10 yrs & within 20 yrs	0%	35%	4.2%
	20 yrs & within 30 yrs	0%	35%	3.5%
	30 yrs & within 40 yrs	0%	35%	26.0%
	40 yrs & within 50 yrs	0%	50%	9.5%
	50 yrs & above	0%	50%	26.2%

This indicator is set to control the Authority's exposure to refinancing risk. The table is based on the contractual final maturity of debt. It indicates a diverse maturity profile.

10	**LOBO Adjusted** Maturity structure of borrowing (U: upper, L: lower)	L	U	Mar-16
	under 12 months	0%	40%	48.4%
	12 months & within 2 years	0%	35%	8.0%
	2 years & within 5 years	0%	35%	6.7%
	5 years & within 10 years	0%	35%	11.1%
	10 yrs & within 20 yrs	0%	35%	4.2%
	20 yrs & within 30 yrs	0%	35%	0.0%
	30 yrs & within 40 yrs	0%	35%	12.0%
	40 yrs & within 50 yrs	0%	50%	9.5%
	50 yrs & above	0%	50%	0.0%

The above table restates table 9 showing the earliest data on which the interest rate on LOBO loans can change as the maturity date. The impact is to restate 44% of debt previously classified as between 20 years and 50+ years to less than one year. As discussed on page 3, the interest rate on LOBO loans is higher than current rates for new borrowing and as a consequence should the lender try to change the rate, the Council can repay with no penalty and refinance at a considerable interest saving. The probability of LOBO calls will be monitored and if deemed high, a plan to refinance will be presented.

11	Sums invested for > 364 days	£0	£0

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 maximum maturity is currently 364 days and no investment exceeds this limit.

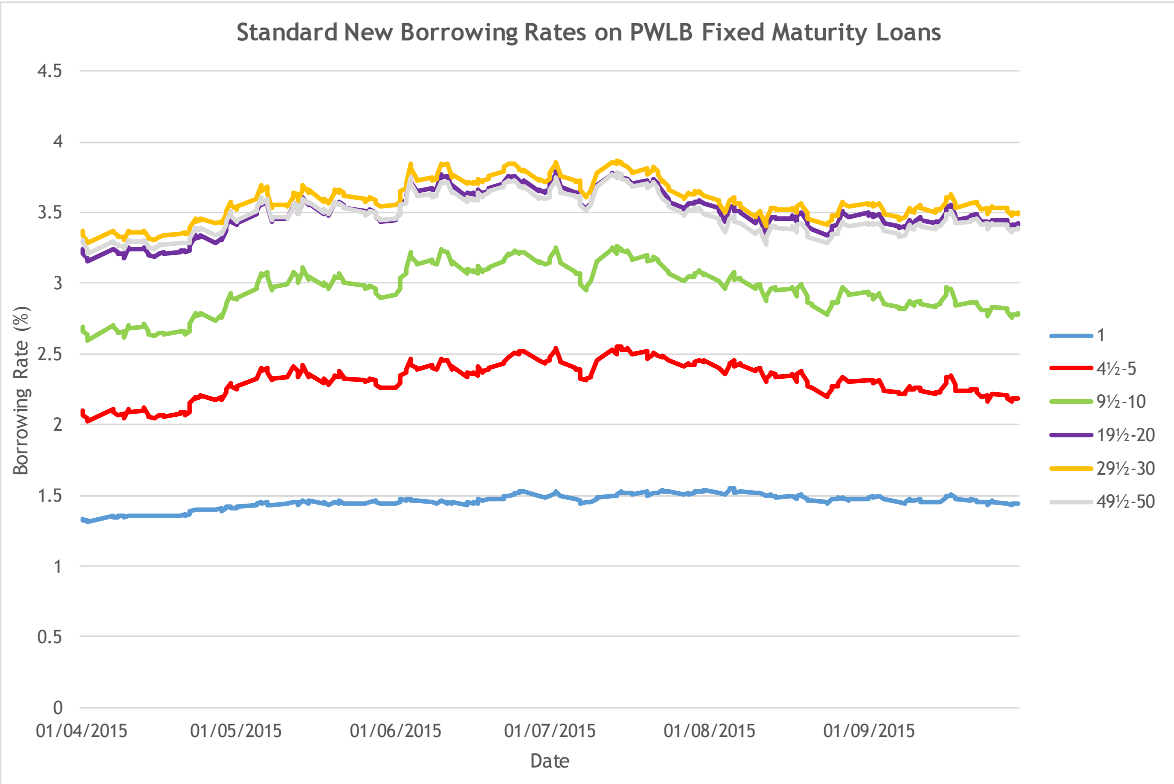
12	Adoption of CIPFA Treasury Management Code of Practice	√	√

Annex 3: Outlook for Q3 and Q4 2015/16

Arlingclose's expectation for the first rise in the Bank Rate (base rate) remains the second calendar quarter of 2016. The pace of interest rate rises will be gradual and the extent of rises limited. The appropriate level for Bank Rate for the post-crisis UK economy is likely to be lower than the previous norm. We would suggest this is between 2.0% and 3.0%. There is also sufficient momentum in the US economy for the Federal Reserve to raise interest rates in 2015, although risks of issues from China could possibly push this back.

The weak global environment and resulting low inflation expectations are likely to dampen long term interest rates. We project gilt yields will follow a shallow upward path in the medium term, with continuing concerns about the Eurozone, and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued. The uncertainties surrounding the timing of UK and US interest rate rises, and the Chinese stock market-led turmoil, are likely to prompt short term volatility in gilt yields.

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Average
Official Bank Rate														
Upside risk			0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.32
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.08
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-0.70



The above graph indicates that long term rates although low by historical standards are sensitive to market assumptions of when base rates will rise and may move quickly when base rates do increase. This has implications for locking in future borrowing costs.