Report for: Corporate Committee 30 November 2017

Item number: **8**

Title: Treasury Management Update Report

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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 2017 in accordance with the CIPFA Treasury Management Code of Practice. It is a requirement of the Code for the report also to be considered by Full Council.

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 2017 and the performance achieved.

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 in Haringey, 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 2017/18 on 27 February 2017. 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 2017/18.

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.

6.5. The quarterly reports during 2017/18 are structured to cover borrowing first and then investments according to these factors, so that members can see how they are being addressed operationally.

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 remains low and the Council's significantly less than the cost of new borrowing and therefore the historic strategy of minimising cash balances has benefited the Council. Borrowing for short term periods with local authorities will be taken when required for liquidity purposes, however longer term interest rates with the Public Works and Loans Board continue to be carefully monitored. Officers will undertake new longer term borrowing, consistent with the Council's approved treasury strategy and capital plans, and in line with advice from Arlingclose when rates fall to sufficiently beneficial levels.

Legal

8.2. The contents and recommendation of this report are in accordance the Code 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

Economic background

11.1. Commodity prices fluctuated over the first half of 2016/17, with oil falling below $45 a barrel before inching back up to $58 a barrel. UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.7%.

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

11.3. The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". The Council's treasury advisor Arlingclose was not convinced the UK's economic outlook justified such a move, but the Bank's interpretation of the data seemed to have shifted. On 2 November 2017 the Bank raised the Bank Rate to 0.50%, the first rise in the Bank Rate since the onset of the global financial crisis in the late 2000s.

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

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

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

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

Financial markets:

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

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

Credit background:

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

11.11. There were a few credit rating changes during the quarter. The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1, placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide and Coventry building societies from negative to stable but downgraded the long-term rating of Leeds BS from A2 to A3. The agency downgraded long-term ratings of the major Canadian banks on the expectation of a more challenging operating environment and the ratings of the large Australian banks on its view of the rising risks from their exposure to the Australian housing market and the elevated proportion of lending to residential property investors.

11.12. S&P also revised Nordea Bank's outlook to stable from negative, whilst affirming their long-term rating at AA-. The agency also upgraded the long-term rating of ING Bank from A to A+.

11.13. Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following Arlingclose's advice, the Authority reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

12. Local Context

12.1. At 31/3/2017 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £575.2m. The Council had £347.0m of borrowing and £18.6m of investments.

12.2. The Council's current strategy is to maintain borrowing and 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 30/09/2017 the Council held £267.5m of long term loans, (a decrease of £3.1m on 31/3/2017), as part of its strategy for funding previous years' capital programmes. The Council expects to take out additional long term borrowing in 2017/18, 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'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 Council's long-term plans change being a secondary objective.

13.3. Affordability and the "cost of carry" remained important influences on the Council'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. Based on professional advice received from the Council's Treasury Management advisor Arlingclose, short-term interest rates are likely to remain low for a significant period.

Borrowing Activity

Borrowing	Balance at 1 Apr 2017 £'000	Borrowing Raised £'000	Maturities £'000	Balance at 30 Sept £'000	Avg Rate %
Short term Borrowing					
- UK Local Authorities	76,400	176,000	202,400	50,000	0.27
Long Term Borrowing					
- PWLB	145,646	0	3,098	142,548	5.51
- LOBO	125,000	0	0	125,000	4.72
TOTAL BORROWING	347,046	176,000	205,498	317,548	4.37

13.4. **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. £25m of these LOBOS had options during the quarter, none of which were exercised by the lender. The Council acknowledges there is an element of refinancing risk even though in the current interest rate environment lenders are extremely unlikely to exercise their options.

Debt Rescheduling

13.5. The premium charge for early repayment of PWLB debt remains relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity.

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 2017/18 the Council's investment balances would range between £10 and £50 million.

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 2017 £'000	Investments Made £'000	Maturities £'000	Balance at 30 June £'000	Avg Rate /Yield %
Short term Investments (call accounts, depos					
- Banks & Building Societies	0	0	0	0	0
UK Government:					
- Deposits at Debt Management Office	10,000	180,405	190,405	0	0.10
- UK Local Authorities	0	0	0	0	0.00
Money Market Funds	8,575	179,205	172,955	14,825	0.19
TOTAL INVESTMENTS	18,575	359,610	363,360	14,825	0.17

Credit Risk

14.5. The table below shows counterparty credit quality as measured by credit ratings and the percentage of the in-house investment portfolio exposed to bail-in risk.

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 %
31/03/2017	3.49	AA	3.06	AA	46
30/06/2017	4.54	A+	4.54	A+	100
30/09/2017	4.39	AA-	4.39	AA-	100

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 0.25% since August 2016, and remained at this level for the period in question ending 30 September 2017. (The rate increased to 0.50% on 2 November 2017.) Short-term money market rates have remained at relatively low levels. Following the reduction in Bank Rate, rates for very short-dated periods (overnight – 1 month) fell to between 0.1% and 0.2%. Debt Management Account Deposit Facility (DMADF) rates were 0.10% during the period to 30 September, however rose to 0.25% following the decision to raise the Bank Rate.

14.7. Investments in Money Market Funds generated an average rate of 0.19%. The Council's forecast investment income for the year is estimated at £36k.

14.8. Although the Bank Rate rose at the beginning of November, this will not have a significant impact on the levels of interest that the Council is able to generate, as rates will still remain at extremely low levels.

15. Compliance with Prudential Indicators

15.1. The Council confirms compliance with its Prudential Indicators for 2017/18, which was set in February 2017 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:

	2017/18 Q2	**2017/18 Full Year**	**2018/19**
Upper limit on fixed interest rate exposure	100%	100%	100%
Actual	78%		
Upper limit on variable interest rate exposure	60%	60%	60%
Actual	22%		

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-Sep-17**

under 12 months	0%	60%	22.1%
12 months & within 2 years	0%	40%	0.0%
2 years & within 5 years	0%	40%	9.4%
5 years & within 10 years	0%	40%	5.9%
10 yrs & within 20 yrs	0%	40%	3.8%
20 yrs & within 30 yrs	0%	40%	3.1%
30 yrs & within 40 yrs	0%	50%	28.9%
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 2017/18

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

Appendix 1: Prudential Indicators

No.	Prudential Indicator	2017/18 Original Indicator*	2017/18 Forecast Position 30 September
CAPITAL INDICATORS			
1	Capital Expenditure	£'000	£'000
	General Fund	133,941	133,941
	HRA	68,901	68,901
	TOTAL	202,842	202,842

2	Ratio of financing costs to net revenue stream	%	%
	General Fund	2.18	2.18
	HRA	9.87	9.87

3	Capital Financing Requirement	£'000	£'000
	General Fund	373,224	373,224
	HRA	271,096	271,096
	TOTAL	644,320	644,320

4	Incremental impact of capital investment decisions	£	£
	Band D Council Tax	13.75	13.75
	Weekly Housing rents	0.20	0.20

5	Borrowing Limits	£'000	£'000
	Authorised Limit / actual debt	536,063	317,548
	Operational Boundary/actual debt	481,105	317,548

*adjusted for slippage from 2016/17

No.	Prudential Indicator	2017/18 Original Indicator		2017/18 Forecast Position 30 September
6	HRA Debt Cap	£'000		£'000
	Headroom	56,442		56,442
7	Gross debt compared to CFR	£'000		£'000
	Gross debt	347,046		317,548
	CFR	644,320		644,320
8	Upper limit – fixed rate exposure	100%		77.9%
	Upper limit – variable rate	60%		22.1%
9	Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**30-Sep-17**
	under 12 months	0%	60%	22.1%
	12 months & within 2 years	0%	40%	0.0%
	2 years & within 5 years	0%	40%	9.4%
	5 years & within 10 years	0%	40%	5.9%
	10 yrs & within 20 yrs	0%	40%	3.8%
	20 yrs & within 30 yrs	0%	40%	3.1%
	30 yrs & within 40 yrs	0%	50%	28.9%
	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-Sep-17**
	under 12 months	0%	60%	45.8%
	12 months & within 2 years	0%	40%	15.7%
	2 years & within 5 years	0%	40%	9.4%
	5 years & within 10 years	0%	40%	5.9%
	10 yrs & within 20 yrs	0%	40%	3.8%
	20 yrs & within 30 yrs	0%	40%	0.0%
	30 yrs & within 40 yrs	0%	50%	16.3%
	40 yrs & within 50 yrs	0%	50%	3.0%
	50 yrs & above	0%	40%	0.0%