Report for:	Corporate Committee 30 January 2018
Item number:	**7**
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 nine months to 31 December 2017 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 31 December 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 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 3rd 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 remain low and significantly less than the cost of new borrowing and therefore the strategy of minimising cash balances is continuing in 2017/18. Borrowing will be taken when required for liquidity purposes with the preference being short term local authorities' loans at very low rates. However longer term interest rates with the Public Works and Loans Board continue to be carefully monitored. The ability to take advantage of low interest rates in this way has resulted in anticipated savings on the treasury management budget.

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

Economic backdrop

11.1. The significant economic event was the increase in the Bank Rate in November by 0.25% to 0.50%, making it the first increase by the Bank of England's MPC to rates since July 2007. The vote to increase Bank Rate was 7-2, reflecting the MPC's growing concern that rising inflation had finally outweighed the risks to growth and largely to meet expectations the Bank itself created. The Bank has reiterated that it expects any future increases in Bank Rate to be at a gradual pace and limited in extent.

11.2. Commodity prices rose over the period with oil increasing to around $67 a barrel from a low of $42 in June. UK Consumer Price Inflation (CPI) index continued to rise with the data print for November showing CPI at 3.1%, its highest since March 2012 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 2.8%.

11.3. The number of unemployed in the economy continued to decrease, although the unemployment rate remained at 4.3%. Consumers' wages continued to shrink, in real terms, given average earnings growth remained subdued at 2.5%, a good deal below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q2 and Q3 GDP growth of 0.3% and 0.4% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings remaining relatively low and real wage growth negative, there are concerns that these will be a constraint on future economic activity.

11.4. In contrast, near-term global growth prospects improved. The US economy grew steadily and inflation increased to 2.2%. As was expected, the Federal Reserve increased its target range of official interest rates in December for the third time in 2017 by 25 basis points to between 1.25% and 1.50%. The Fed is expected to deliver three more increases in 2018 and a further two in 2019. The central bank's growth forecasts were revised up based on the newly-passed personal and corporate tax rate cuts proposed by Donald Trump.

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

11.6. Financial markets: Gilt yields were broadly stable over the quarter as much of the uncertainty which plagued the first half of the year dissipated. The yield on the 5-year gilts fell slightly to 0.72% at the end of the quarter, down from 0.80% in September. The 10-year gilts similarly fell from 1.38% to 1.19% at the end of the quarter and the 20-year gilts from 1.94% to 1.73%.

11.7. The FTSE 100 continued to climb, reaching yet another record high of 7688 at the end of calendar year. Money markets rates, unsurprisingly, have increased over the quarter: 1-month, 3-month and 12-month LIBID rates have averaged 0.43%, 0.47% and 0.76% over the period October-December.

11.8. Credit background: UK bank credit default swaps have remained broadly stable throughout the quarter. Bank share prices have not moved in any pattern.

11.9. Much of the activity by credit rating agencies during the quarter has related to the upcoming UK bank ringfencing which will take effect in 2018. Ringfencing requires the larger UK banks to separate their core retail banking activity from the rest of their business, resulting in two separate banks. In general, the agencies expect to give the ringfenced "retail" bank a higher credit rating than the non-ringfenced "investment" bank. In practice, this will only affect Barclays, HSBC, Lloyds and RBS as other UK banks and building societies either only conduct retail banking activities or have less than £25 billion of deposits covered by the Financial Services Compensation Scheme.

11.10. Barclays Bank plc was upgraded to A from A- by Standard & Poor's (S&P), after the bank announced its plans for its ringfenced bank, Barclays Bank UK plc, and the non-ringfenced bank, Barclays Bank plc. S&P also assigned preliminary ratings of 'A/A-1' to Barclays Bank UK plc.

11.11. In November S&P revised upwards the outlook of various UK banks and building societies to positive or stable and simultaneously affirmed their long and short-term ratings. These reflect the agency's view that the institutions now show increased resilience, have made substantial progress in meeting regulatory capital requirements and are now better positioned to deal with uncertainties and potential turbulence in the run-up to the UK's exit from the EU in March 2019.

11.12. There have been no changes to Arlingclose's investment advice regarding banks and building societies during the quarter.

Regulatory Updates

11.13. MiFID II: As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities will be treated as retail clients but can “opt up” to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year’s relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

11.14. Haringey meets the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. The Authority will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

11.15. CIPFA Codes: CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The Authority is currently considering the changes from the 2011 Code for incorporation into future Treasury Management Strategies and monitoring reports.

11.16. The 2017 Prudential Code introduces the requirement for a Capital Strategy which sets out the long-term context of capital expenditure and investment decisions and their associated risks and rewards along with an overview of how risk is managed for future financial sustainability. Where this strategy is produced, it must be approved by full Council, and the determination of the Treasury Management Strategy can then be delegated to a committee.

11.17. In the 2017 Treasury Management Code the definition of ‘investments’ has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy.

11.18. Proposed changes to the Investment Guidance include a wider definition of investments to include non-financial assets held primarily for generating income return and a new category called “loans” (e.g temporary transfer of cash to a third party, joint venture, subsidiary or associate). The draft Guidance introduces the concept of proportionality, proposes additional disclosure for borrowing solely to invest and also specifies additional indicators. Investment strategies should detail the extent to which core expenditure is reliant on investment income and a contingency plan should yields on investments fall.

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 external 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 31/12/2017 the Council held £307.9m of long term loans, (an increase of £37.2m on 31/3/2017), as part of its strategy for funding previous years' capital programmes. The Council raised £50m of additional PWLB borrowing in year and repaid £12.8m of old borrowing. The Council was able to take advantage of the current low interest environment, and this new borrowing was arranged at an average rate of 2.61%. The Council's underlying need to borrow will grow further in coming years due to the Council's capital programme. Interest rates are carefully monitored and advice is taken from the Council's treasury adviser Arlingclose in relation to when 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 31 Dec 2017 £'000	Avg Rate %
Short term Borrowing					
- UK Local Authorities	76,400	228,000	267,400	37,000	0.29
Long Term Borrowing					
- PWLB	145,646	50,000	12,781	182,865	5.20
- LOBO	125,000	0	0	125,000	4.72
TOTAL BORROWING	347,046	278,000	280,181	344,865	4.50

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. £50m 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 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 £0 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 31 Dec 2017 £'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	522,385	522,385	10,000	0.16
- UK Local Authorities	0	0	0	0	0.00
Money Market Funds	8,575	253,375	246,950	15,000	0.20
TOTAL INVESTMENTS	18,575	775,760	769,335	25,000	0.19

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
30/12/2017	4.25	AA-	3.78	AA-	60

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, but was increased to 0.50% on 2 November 2017. Short-term money market rates have increased slightly, but remain at relatively low levels. Debt Management Account Deposit Facility (DMADF) rates are currently 0.25%, an increase from 0.10% in the period before the rate rise.

14.7. Investments in Money Market Funds generated an average rate of 0.20%. The Council's forecast investment income for the year is estimated at £43k.

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 Q3	2017/18 Full Year	2018/19
Upper limit on fixed interest rate exposure	100%	100%	100%
Actual	86%		
Upper limit on variable interest rate exposure	60%	60%	60%
Actual	14%		

18.4. 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.

18.5. **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	31-Dec-17
under 12 months	0%	60%	14.1%
12 months & within 2 years	0%	40%	2.5%
2 years & within 5 years	0%	40%	5.9%
5 years & within 10 years	0%	40%	5.5%
10 yrs & within 20 yrs	0%	40%	5.0%
20 yrs & within 30 yrs	0%	40%	15.9%
30 yrs & within 40 yrs	0%	50%	26.6%
40 yrs & within 50 yrs	0%	50%	24.6%
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 relatively low and real earnings growth (i.e after inflation) struggles in the face of higher inflation.

16.2. The Bank of England's Monetary Policy Committee's decision to raise bank rate is likely to reduce inflation, all other things remaining equal, but is likely to have negative effect on what was already a weak growth outlook.

16.3. Arlingclose, the Council's treasury advisor's central case is for Bank Rate to remain at 0.50% over the forecast period, whilst introducing upside risks from September 2018, as shown below, and downside risks from March 2019. Arlingclose's central case is for gilt yields to remain broadly stable across the medium term.

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

Appendix 1: Prudential Indicators

No.	Prudential Indicator	2017/18 Original Indicator	2017/18 Forecast Position 31 December
CAPITAL INDICATORS			
1	Capital Expenditure	£'000	£'000
	General Fund	133,941	51,990
	HRA	68,901	68,901
	TOTAL	202,842	120,891
2	Ratio of financing costs to net revenue stream	%	%
	General Fund	2.18	1.58
	HRA	9.87	9.44
3	Capital Financing Requirement	£'000	£'000
	General Fund	374,671	351,995
	HRA	278,721	253,811
	TOTAL	653,392	605,806
4	Incremental impact of capital	£	£
	Band D Council Tax	13.75	13.65
	Weekly Housing rents	0.20	0.71
5	Borrowing Limits	£'000	£'000
	Authorised Limit / actual debt	536,063	344,865
	Operational Boundary/actual debt	481,105	344,865

No.	Prudential Indicator	2017/18 Original Indicator		Forecast Position 31 December 2017
6	HRA Debt Cap		£'000	£'000
	Headroom		56,442	73,727
7	Gross debt compared to CFR		£'000	£'000
	Gross debt		347,046	344,865
	CFR		653,392	605,806
8	Upper limit – fixed rate exposure		100%	85.9%
	Upper limit – variable rate		60%	14.1%
9	Maturity structure of borrowing (U: upper, L: lower)	**L**	**U**	**31-Dec-17**
	under 12 months	0%	60%	14.1%
	12 months & within 2 years	0%	40%	2.5%
	2 years & within 5 years	0%	40%	5.9%
	5 years & within 10 years	0%	40%	5.5%
	10 yrs & within 20 yrs	0%	40%	5.0%
	20 yrs & within 30 yrs	0%	40%	15.9%
	30 yrs & within 40 yrs	0%	50%	26.6%
	40 yrs & within 50 yrs	0%	50%	24.6%
	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	**31-Dec-17**
	under 12 months	0%	60%	43.1%
	12 months & within 2 years	0%	40%	9.7%
	2 years & within 5 years	0%	40%	5.9%
	5 years & within 10 years	0%	40%	5.5%
	10 yrs & within 20 yrs	0%	40%	5.0%
	20 yrs & within 30 yrs	0%	40%	13.0%
	30 yrs & within 40 yrs	0%	50%	15.0%
	40 yrs & within 50 yrs	0%	50%	2.8%
	50 yrs & above	0%	40%	0.0%

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