Havering
LONDON BOROUGH

	Item 9
Audit Committee **09 05 2017**	**REPORT**

Subject Heading:	Treasury Management Update Quarter 4 2016/17
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Policy context:	The code of practice on treasury management 2009 recommends treasury activities to be reported to a scrutiny committee on a quarterly basis
Financial summary:	There are no direct financial implications from the report

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[X]
Places making Havering	[]
Opportunities making Havering	[]
Connections making Havering	[]

SUMMARY

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 to full Council at least twice yearly (mid-year and at year end). This report provides an additional quarterly update to be reviewed by the Audit Committee.

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.

RECOMMENDATIONS

- To note the treasury management activities detailed in the report

REPORT DETAIL

1. Investments

The average level of funds available for investment purposes has decreased from £235m in quarter 3 to £201m in quarter 4.

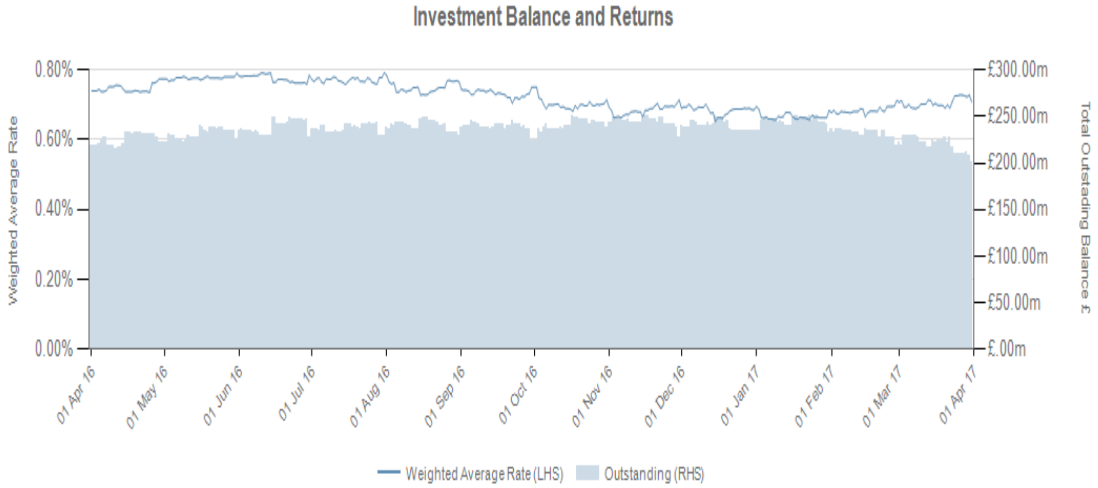
A full breakdown of the Authority's deposits at 31 March 2017 can be found as appendix A.

Table A: Investment performance for quarter ending 31 March 2017

Benchmark	Benchmark Return 3 month LIBOR %	Budgeted Rate of Return %	Actual Rate of Return %	Investment Interest Earned to Period End £
Quarter 1	0.58	0.60	0.77	236,741
Quarter 2	0.51	0.60	0.76	477,873
Quarter 3	0.47	0.60	0.69	922,569
Quarter 4	0.44	0.60	0.72	1,411,654

*** excludes interest from Mercury Land Holding Investments

Graph 1: 2016/17 Monthly Investment Balance and Returns



At the August Bank of England MPC meeting, the UK Bank Rate was reduced to 0.25% and as a result short-term money market rates dropped considerably with many institutions withdrawing from the market for deposits. This can be seen by the reduction of 3 month LIBOR which in Quarter 2 was 0.51% and Quarter 3 0.47%, closing at 0.44% at 31 March 2017.

As illustrated in table A above, the Authority outperformed LIBOR in the fourth quarter by 28bps. This was achieved by locking into longer term deposits to negate the effect of a falling 3 month LIBOR whilst maintaining security on its deposits.

The Authority has also outperformed its budgeted rate of return by 12bps which in addition to a higher cash position has led to excess interest earned to 31 March 2017 of £0.275m.

It was expected early in the financial year that 3 month LIBOR would drop further and as maturing deposits were replaced with new investments at lower rates the excess interest was not declared within the Council's overall revenue position.

To achieve reasonable yield in 2017/18, the Council will further consider investing additional cash in secure liquid investments with duration exceeding 364 days after discussions with Arlingclose.

In addition, the S151 Officer will ensure that for all investments, security and liquidity is paramount before yield. The budget for investment income in 2017/18 is 0.60% (£0.765m).

Table B: Average Monthly Balances in 2016/17

Year	Quarter	Month	Date	Days	Average Balance	Weighted Average Rate
2016/2017	1	April	April average	30	£225,778,705.31	0.74663%
		May	May average	31	£231,368,391.85	0.77670%
		June	June average	30	£238,976,399.31	0.77540%
			2016/2017 Q1 average	91	£232,033,772.37	0.76661%
	2	July	July average	31	£237,221,516.71	0.77122%
		August	August average	31	£240,432,998.40	0.74930%
		September	September average	30	£239,591,245.57	0.73210%
			2016/2017 Q2 average	92	£239,076,384.08	0.75101%
	3	October	October average	31	£240,394,144.64	0.70208%
		November	November average	30	£244,632,454.38	0.68442%
		December	December average	31	£240,359,298.91	0.68442%
			2016/2017 Q3 average	92	£241,764,460.67	0.69034%
	4	January	January average	31	£244,921,840.64	0.66661%
		February	February average	28	£232,576,840.97	0.68362%
		March	March average	31	£220,156,185.06	0.70570%
			2016/2017 Q4 average	90	£232,550,781.60	0.68465%
			2016/2017 average	**365**	**£236,389,044.78**	**0.72309%**

2. Current Investment Opportunities

From time to time the Council is made aware of long term investment opportunities by other oneSource Councils, brokers or investment advisers.

These investments may require quick due diligence/assessment and decision making. It is anticipated that amendments will be required to be made to the Council's 2017/18 treasury management strategy to facilitate a process for urgent decision making.

Examples of such investments are: investments in Solar bond with returns of 4% per annum for years 1 to 4 and 6% in year 5. As well as a 10 year deposit at gilts plus 50bps secured on a segregated pool of Local Authority loans selected by the investor.

3. New borrowing

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 instead, referred to as internally borrowing.

Due to the above no long term borrowing was undertaken during the quarter but this will be kept under continuous review as capital spending is monitored and new opportunities emerge in the market.

The Council has also not borrowed in advance of need during the 4th quarter of 2016/17.

New borrowing opportunities available in the markets during the period which may provide borrowing rates at less that equivalent PWLB duration become available from time to time.

Where available the S151 Officer will consider the cost of carry before making a decision to borrow in advance of need or forward fixing borrowing rates. Such opportunities could be used by the Council after careful consideration to fund Council's Prefunding of Pension Fund past service cost.

4. Debt Rescheduling

Debt rescheduling opportunities have been almost non-existent in the current economic climate and consequent structure of interest rates following increases in PWLB new borrowing rates in October 2010.

The possibility of debt rescheduling is regularly discussed with our treasury advisers and is a regular agenda item at the quarterly treasury meeting held between the treasury department, the S151 officer and the lead Member.

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.

5. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) were included and approved by full Council as part of the Treasury Management Strategy Statement (TMSS) in February.

During the financial year, the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

5.1 Interest Rate Exposures

This indicator is set to control the Authority's exposure to interest rate risk on its debt portfolio. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed will be:

Table C: Interest rate exposure

	2016/17 %	2017/18 %	2018/19 %
Upper limit on fixed interest rate exposure*	100	100	100
Actual	98.1		
Upper limit on variable interest rate exposure	25	25	25
Actual	1.9		

*Fixed rate borrowing 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.

Having larger amounts of fixed interest rate borrowing gives the Authority greater stability with regards to its interest payments and reduces the risk of higher interest costs should interest rates rise. Traditionally local Authorities have taken advantage of fixing interest rates long term to reduce interest rate exposure.

5.2 Maturity Structure of Borrowing

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

Table D: Maturity structure of borrowing

	Upper %	Lower %	Actual %
Under 12 months	40	0	1.1
12 months and within 24 months	40	0	0
24 months and within 5 years	60	0	0.5
5 years and within 10 years	75	0	1.9
10 years and above	100	25	96.5

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

5.3 Principal Sums Invested for Periods Longer than 364 days

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 limits on the total principal sum for investments greater than 1 year invested to final maturities beyond the period end will be:

Table E: Investments longer than 364 days

	2015/16 £m	2016/17 £m	2017/18 £m
Limit on principal invested beyond year end	75	50	£50
Actual	28.8	48.8	21.1

5.4 Liquidity Treasury Indicator

The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments overnight and within a rolling three month period without additional borrowing.

Table F: Liquidity

	Target £m	Actual £m
Total cash available by the next working day	5	6.9*
Total cash available within 3 months	30	46

*The level of instant access cash increased slightly due to additional cash made available to ensure that there was funding in place for all year end creditor expenditure.

5.5 Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement (CFR) for the current and next two financial years. This is a key indicator of prudence.

Table G: Gross Debt and CFR

	31.03.16 Actual £m	31.03.17 Actual £m	31.03.18 Estimate £m
Long Term Debt	210.2	210.2	278.3
CFR	235	251	306

Total debt is expected to remain below the CFR during the year.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

5.6 Operational Boundary for External Debt

The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Table H: Operational Boundary

Operational Boundary	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Borrowing	210.2	276.3	310.6
Other long-term liabilities	2.0	2.0	2.0
Total	**212.2**	**278.3**	**312.6**
Long Term Debt	**210.2**	**210.2**	**210.2**
Headroom	**n/a**	**68.1**	**102.4**

5.7 Authorised Limit 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.

Table I: Authorised limit

Authorised Limit	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Borrowing	284.6	303.9	341.7
Other long-term liabilities	2.0	2.0	2.0
Total Debt	**286.6**	**305.9**	**343.7**
Long Term Debt	**210.2**	**210.2**	**210.2**
Headroom	**76.4**	**95.7**	**133.5**

IMPLICATIONS AND RISKS

Financial implications and risks:

There are no direct financial implications from this report.

Legal implications and risks:

There are no apparent legal implications or risks from noting this Report.

Human Resources implications and risks:

There are no HR implications from this report

Equalities implications and risks:

There are no Equalities implications arising from this report

BACKGROUND PAPERS

None

Appendix A

Detail of Deposits as at 31st March 2017

Class	Type	Deal Ref	Start / Purchase Date	Maturity Date	Counterparty	Profile	Rate	Principal O/S (£)
Deposit	Fixed	3256	07/09/16	06/09/17	DBS Bank Ltd	Maturity	0.5000%	-2,000,000.00
Deposit	Fixed	3260	03/10/16	03/04/17	Commonwealth Bank of Australia	Maturity	0.4000%	-5,000,000.00
Deposit	Fixed	3263	07/10/16	07/04/17	Commonwealth Bank of Australia	Maturity	0.4000%	-5,000,000.00
Deposit	Fixed	3264	10/10/16	10/10/17	Lloyds Bank plc	Maturity	1.0000%	-3,000,000.00
Deposit	Fixed	3265	13/10/16	12/10/17	Rabobank Nederland	Maturity	0.6000%	-5,000,000.00
Deposit	Fixed	3266	17/10/16	17/10/17	Lloyds Bank plc	Maturity	1.0000%	-4,000,000.00
Deposit	Fixed	3267	17/10/16	13/04/17	Nationwide Building Society	Maturity	0.4300%	-5,000,000.00
Deposit	Fixed	3268	18/10/16	17/10/17	Rabobank Nederland	Maturity	0.6400%	-5,000,000.00
Deposit	Fixed	3270	20/10/16	19/07/17	Highland Council	Maturity	0.3500%	-2,000,000.00
Deposit	Fixed	3271	20/10/16	20/04/17	Nationwide Building Society	Maturity	0.4200%	-3,000,000.00
Deposit	Fixed	3272	01/11/16	01/11/18	Northumberland County Council	Maturity	0.5500%	-5,000,000.00
Deposit	Fixed	3273	04/11/16	03/11/17	Eastleigh Borough Council	Maturity	0.4400%	-5,000,000.00
Deposit	Fixed	3274	08/11/16	08/05/17	Coventry Building Society	Maturity	0.3800%	-5,000,000.00
Deposit	Fixed	3275	15/11/16	15/11/18	Lancashire County Council	Maturity	0.5700%	-5,000,000.00
Deposit	Fixed	3276	16/11/16	16/11/20	Northumberland County Council	Maturity	1.0000%	-5,000,000.00
Deposit	Fixed	3277	16/11/16	16/11/21	Northumberland County Council	Maturity	1.1000%	-5,000,000.00
Deposit	Fixed	3278	29/11/16	31/05/17	Highland Council	Maturity	0.3500%	-5,000,000.00
Deposit	Fixed	3279	05/12/16	28/04/17	Goldman Sachs International	Maturity	0.4900%	-5,000,000.00
Deposit	Fixed	3280	13/12/16	23/06/17	Goldman Sachs International	Maturity	0.5200%	-5,000,000.00
Deposit	Fixed	3227	07/04/16	06/04/17	Bank of Montreal	Maturity	0.7700%	-4,000,000.00
Deposit	Fixed	3229	11/04/16	10/04/17	Oversea-Chinese Banking Corp	Maturity	0.7800%	-5,000,000.00
Deposit	Fixed	3236	03/05/16	02/05/17	Rabobank Nederland	Maturity	0.8050%	-5,000,000.00
Deposit	Fixed	3239	16/05/16	15/05/17	Oversea-Chinese Banking Corp	Maturity	0.8000%	-4,000,000.00
Deposit	Fixed	3247	15/07/16	14/07/17	Lloyds Bank plc	Maturity	1.0500%	-4,000,000.00
Deposit	Fixed	3249	22/07/16	24/07/17	Lloyds Bank plc	Maturity	1.0500%	-5,000,000.00
Deposit	Fixed	3250	01/08/16	31/07/17	Australia and New Zealand Banking Group Limited	Maturity	0.5300%	-3,000,000.00
Deposit	Fixed	3194	04/11/15	05/11/18	Lancashire County Council	Maturity	1.3000%	-5,000,000.00
Deposit	Fixed	3199	29/02/16	26/02/21	Newcastle upon Tyne City Council	Maturity	1.8000%	-5,000,000.00
Deposit	Fixed	3202	26/04/16	26/04/21	London Borough of Islington	Maturity	1.7500%	-5,000,000.00
Deposit	Fixed	3145	19/06/15	19/06/18	Lancashire County Council	Maturity	1.2000%	-5,000,000.00
Deposit	Fixed	3283	11/01/17	11/07/17	Nationwide Building Society	Maturity	0.4200%	-5,000,000.00
Deposit	Fixed	3284	16/01/17	15/01/18	Lloyds Bank plc	Maturity	0.9000%	-5,000,000.00
Deposit	Fixed	3288	01/02/17	01/11/17	North Lanarkshire Council	Maturity	0.4800%	-5,000,000.00
Deposit	Fixed	3290	27/01/17	27/04/17	Goldman Sachs International	Maturity	0.5000%	-5,000,000.00
Deposit	Fixed	3292	03/02/17	02/02/18	Lloyds Bank plc	Maturity	0.9000%	-3,000,000.00
Deposit	Fixed	3291	17/02/17	22/11/17	Highland Council	Maturity	0.4800%	-5,000,000.00
Fixed Total							**0.7494%**	**-162,000,000.00**
Deposit	Call - 95 days notice	3186	30/09/15		Santander UK plc	Maturity	0.4475%	-20,175,640.45
Deposit	Call - 95 days notice	3282	09/01/17	26/06/17	Goldman Sachs Int Bank (95 Days)	Maturity	0.5200%	-3,000,000.00
Call - 95 days notice Total							**0.4569%**	**-23,175,640.45**
Deposit	MMF	3287	20/01/17		HSBC Global Liquidity Sterling G	Maturity	0.2310%	-6,920,000.00
MMF Total							**0.2310%**	**-6,920,000.00**
Deposit	Bond	3178	14/10/15	12/04/18	Yorkshire Building Society	Maturity	1.2999%	-5,000,000.00
Bond Total							**1.2999%**	**-5,000,000.00**
Deposit	Floating Rate Note	3255	31/08/16	08/07/19	Santander UK plc	Maturity	0.6490%	-1,006,116.20
Deposit	Floating Rate Note	3254	31/08/16	29/05/18	Santander UK plc	Maturity	0.5622%	-2,802,186.77
Floating Rate Note Total							**0.5851%**	**-3,808,302.97**
Deposit Total							**0.7084%**	**-200,903,943.42**

Appendix B

Regulatory Update

Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) protects most deposits at UK banks, building societies and credit unions in the event of default.
The main exceptions relate to deposits made by local authorities with annual budgets exceeding €500,000 and deposits by other financial institutions.

On 30th January 2017, the FSCS increased the deposit compensation limit by £10,000 to £85,000. The Prudential Regulation Authority will normally review the protection limit every five years in order to factor in exchange rates fluctuations, as the limit is based on the €100,000 specified in the EU Deposit Guarantee Schemes Directive. However, the large fall in sterling since the EU referendum has led to an interim change.

Deposits covered by the FSCS are also exempt from bail-in, and eligible depositors are therefore fully protected against bank failure up to the £85,000 limit.

Deposits by individuals and SMEs of more than £85,000 have some additional protection against bank insolvency or bail-in, as they are considered preferred creditors. They would therefore only be bailed-in after all other unsecured creditors have been wiped out. In order to qualify as an SME, a company must meet at least two of the following criteria: (i) balance sheet assets of below €12.5m, (ii) net turnover of below €25m, and (iii) average number of employees during the year of fewer than 250.

Local authorities with annual budgets above €500,000 and all financial institutions remain excluded from both FSCS protection and treatment as preferred creditors. Their deposits are classified as senior unsecured creditors and are therefore exposed to losses in the event of a bank failure, along with bondholders and other creditors.

Money Market Fund Regulatory Reform

On-going European Money Market Fund regulatory reform process is heading toward its last phase before implementation. He detail of the ‘Regulation of the European Parliament and European Council on Money Market Funds’ has been agreed by the relevant EU policymaking bodies and is now subject to final approval. The key features of the regulation include:

MMF Structure Options
Public Debt Constant Net Asset Value (CNAV) MMFs – must invest 99.5% of their assets into government debt instruments
Low Volatility Net Asset Value (LVNAV) MMFs – are permitted to maintain a constant dealing Net Asset Value, providing that the fund’s market Net Asset Value does not deviate from the dealing NAV by more than 20 basis points, alongside other criteria.

Variable Net Asset Value MMFs – assets are marked to market, meaning the dealing NAV will fluctuate.
Liquid Asset Ratios
Requirements to hold minimum levels of daily and weekly liquid assets differ between type of fund structure.

Implementation Timeline
An implementation of 18 months has been set out for existing funds, commencing from the date of publication of the regulation in the Official Journal of the European Union. This publication is currently is expected to happen in the first half of 2017.

It is expected that most of the short-term MMFs the Council currently invests in will convert to the LVNAV structure but it remains to be seen how each fund manager reacts to the final regulation. It would not be surprising to see some industry consolidation.
The Council will continue to adhere to the principles of Security, Liquidity and Yield.
The Council's treasury management adviser - Arlingclose will continue to scrutinise MMFs on an ongoing basis and have discussions with each of the funds on their credit and investment approach. The Council will immediately suspend the use of any fund should there be concerns.

Recent changes by the Debt Management Office (DMADF)

The Debt Management Office on 24th February 2017 changed the interest rate for DMADF deposits with **immediate effect**. The interest rate for deposits from overnight to six months is now **0.10%**. The previous rates were 0.15% for overnight to three month deposits, and 0.10% for four month to six month deposits.

MiFID II

This EU directive tightens the regulation of financial markets, including the client classification of local authorities, taking effect from January 2018.

The existing MiFID I allows all local authorities to be classed as professional clients with wider market access and cheaper fees than individuals and SMEs classed as retail clients. The new MiFID II will class all local authorities as retail clients with the ability to opt up to professional client status providing they meet certain thresholds. The FCA has some leeway over what thresholds are applied in the UK and proposed a £15m minimum investment balance, a history of 40 relevant transactions a year, and one year's experience in the financial sector.

There was extensive lobbying from across the local authority and pension fund communities against these suggestions. While the FCA is used to financial service firms asking for less regulation, they will have been surprised to hear so many customers arguing against it too. It is anticipated that some changes will be made to the thresholds, although the final outcome will not be known until early July.