Havering
LONDON BOROUGH

AUDIT COMMITTEE	**28 FEBRUARY 2018**
Subject Heading:	**TREASURY MANAGEMENT QUARTER 3 UPDATE 2017/18**
SLT Lead:	**Debbie Middleton** **Interim Chief Financial Officer**
Report Author and contact details:	**Reena Patel / Stephen Wild** **Treasury Manager / Head of Pensions and Treasury** **01708432485** **Reena.Patel@onesource.co.uk**
Policy context:	**The code of practice on treasury management 2011 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	[x]
Places making Havering	[x]
Connections making Havering	[x]

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 per year (mid-year and at year end). This report provides an additional quarterly update to be reviewed by the Audit Committee.

The Authority's treasury management strategy for 2017/18 was approved at a meeting of the Authority in February 2017 and revisions to the strategy were approved at a meeting of the Authority in September 2017.

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 activity on treasury managed investments and borrowings and the associated monitoring and control of risk.

RECOMMENDATIONS

- To note the treasury management activities for the third quarter detailed in the report

REPORT DETAIL

1. External Context

1.1. Economic Backdrop

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. MPC at its meeting on the 8th February kept the bank rate on hold but indicated that the pace of interest rate increases could accelerate if the economy remains on its current track. Economists think the next rate rise could occur this May but they are not certain. This has added pressure on investment yields and officers have taken advantage of that by taking some longer term investment decisions.

The Bank also raised its forecast of growth this year from 1.5% last November to 1.7% now. But it says its forecasts are based on a "smooth" adjustment to Britain's departure from the European Union.

The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.8%.

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.

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.

Credit Background

Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business will take effect in 2018.

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, RBS and Lloyds to a lesser extent 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.

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.

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

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1.2 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.

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. This strategy must be approved by full Council, and the determination of the Treasury Management Strategy can then be delegated to a committee.

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.

Revised Ministry of Housing, Communities and Local Government (MHCLG) Guidance on Investments and Minimum Revenue Provision (MRP):

In November the MHCLG (previously the Department of Communities and Local Government (DCLG)), consulted on proposed changes to its Guidance on Local Government Investments and Statutory Guidance on Minimum Revenue Provision (MRP) with a deadline for responses of 22nd December.

The revised Investment Guidance was published on 2ndt February 2018 and comes into force on 1st April 2018. There is acceptance that it is unlikely that all local authorities will have time to adopt the changes before 31st March 2018 but it will be necessary include the disclosures in full in the first strategy presented to Full council after 1st April 2018.

It compels councils to be more transparent about the risks of investments but stopped short of setting limits – an idea mooted in the consultation. It also says that they should prioritise security over yield in choosing investments. It says: “Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed”

It adds that where a Local Authority chooses to disregard this guidance it must say why and what it is doing to manage the risk.

Specifically it includes 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 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. Loans to local authority companies and joint ventures can be made although they may not be seen as prudent if adopting a narrow definition of security and liquidity

Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:

- Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and

- The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

Loans made solely to generate a profit would be outside of the Statutory Guidance and need to be explained within the Capital or Investment Strategy

There is a change to the basis of prudent MRP to "cover the gap between the Capital Financing Requirement (CFR) and grant income/capital receipts"; it cannot be a negative charge and can only be zero if the CFR is nil or negative. Guidance on asset lives has been updated, applying to any calculation using asset lives. Any change in MRP policy cannot create an overpayment; the new policy must be applied to the outstanding CFR going forward only.

Officers are currently reviewing this new guidance and the CIPFA revised codes and in particular how it impacts on this authority's commercial agenda and will report back in detail at a future Audit Committee. Furthermore Officers will provide training for those members tasked with governance on these activities.

2. Treasury Management Summary

The treasury management position as at 31st December 2017 and the change over the period is shown in table 1 below.

Table 1: Treasury Management Summary as at 31st December 2017

	31.3.17 Balance £m	Movement £m	31.12.17 Balance £m	31.12.17 Rate %
Long-term borrowing	210.234		210.234	3.60
Short-term borrowing	2.512	16.737	19.249	0.38
Total borrowing	**212.746**	**16.737**	**229.483**	**3.32**
Long-term investments	40.000	-15.000	25.000	1.26
Short-term investments	130.808	28.792	159.600	0.60
Cash and cash equivalents	30.096	15.889	45.985	0.48
Total investments	**200.904**	**29.681**	**230.585**	**0.65**
Net borrowing	**11.842**	**-12.944**	**-1.102**	**2.67**

Longer term investments have seen a net reduction of £15m since the beginning of the year; this has been due to the lack of available opportunities in the money markets yielding an attractive rate of return in the long term. The situation is constantly under review to take advantage of opportunities as and when they arise.

3. Borrowing Strategy

3.1 The 31st December 2017 borrowing position is show in table 2 below.

Table 2: Borrowing Position

	Balance at 01/04/17 £m	Raised £m	Repaid £m	Balance at 31/12/17 £m	Weighted Average Rate %
Loans					
PWLB	203.234	-	-	203.234	**3.60**
Bank (LOBO)	7.000	-	-	7.000	**3.60**
Local Authorities and Other (Short Term Borrowing)	2.512	58.350	41.612	19.250	**0.38**
Total Loans	**212.746**	**58.350**	**41.612**	**229.484**	**3.32**

4. Investment Activity

4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position during the half year is shown in Table 3 below.

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.

Table 3: Investment Activity

	Balance at 01/04/17 £m	Raised £m	Repaid £m	Balance at 31/12/17 £m	Weighted Average Rate %
Investments					
Fixed Deposits	162.000	165.100	142.500	184.600	0.69
Money Market Funds	6.920	368.777	366.940	8.757	0.40
Call Accounts	23.176	26.207	21.176	28.207	0.50
Covered Bonds	8.808	0.431	0.219	9.020	0.52
Total investments	**200.904**	**560.515**	**530.835**	**230.584**	**0.65**

4.2 At 31 December 2017, the Authority's risk adjusted return was higher than the Arlingclose universe and average for its 13 London Boroughs. The Authority's average return on investments was 0.65% compared to an average return of 0.54% on internally managed investments within the Arlingclose benchmarking club.

4.3 The Authority has progressed on with the investments in the Solar Bonds issued by Rockfire Capital Ltd, which were initially purchased by Warrington Borough Council whilst the necessary approvals for this investment class were obtained by the Authority. A target date of 15th February has been set to transfer the bonds from Warrington Borough Council to the Authority, the issuer (Rockfire Capital) will then update the bond register to reflect the above changes.

Appendix A shows the breakdown of counterparties and investments for the authority.

Appendix B provides a summary of Arlingclose's quarterly benchmarking report.

5. Budgeted Income and Return

5.1 The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below:

Table 4: 2017/18 Treasury Investment Performance to 31/12/17

	Benchmark Return 3 month LIBOR (Average Quarterly Rate) %	Budgeted Rate of Return %	Budgeted Interest (Full Year) £m	Actual Rate of Return %	Actual Interest to end of Quarter £m
Quarter 1	0.31	0.60	1.350	0.68	0.373
Quarter 2	0.30	0.60	1.350	0.64	0.359
Quarter 3	0.47	0.60	1.350	0.64	0.364
Total			1.350		1.096

Based on the actuals for Quarter 1- 3 and a projected position for Quarter 4, it is very likely that the Authority will achieve the investment income budget set out for 2017-18.

6. New borrowing

6.1 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.

6.2 As short-term interest rates have remained, and are likely to rise by a limited extent over the forthcoming two years and remain significantly 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 internal borrowing.

6.3 As a result no long term borrowing has been undertaken during the current year but this will be kept under continuous review.

7. Compliance with Treasury and Prudential Limits

7.1 During the year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority Treasury Management Strategy Statement and in compliance with the authority’s Treasury Management

Practices. An update on indicators and limits are reported in **Appendix C** of this report.

IMPLICATIONS AND RISKS

Financial implications and risks:

There are no direct financial implications arising 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

1. 2017/18 Treasury Management Strategy
2. 2016/17 Treasury Management Annual report and Proposed Changes to 2017/18 Treasury Management Strategy
3. Arlingclose Investment Benchmarking Q3 2017

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Appendix A

Table 1 breakdown of Deposits at 31st December 2017

Institution Type	31st December 2017 Actual £m	30th September 2017 Actual £m
UK Banks		
Goldman Sachs INT"L Bank	23.100	23.100
Lloyds Bank PLC	13.000	15.000
Close Brothers Ltd	5.000	5.000
Royal Bank of Scotland	0.100	0.100
Santander UK PLC	5.008	0.005
Santander UK PLC (Covered Bond)	3.803	3.804
UK Building Societies		
Nationwide Building Society	-	5.000
Yorkshire Building Society (Covered Bond)	5.217	5.000
Local Authorities & Other Public Sector		
Birmingham City Council	15.000	15.000
Blackburn with Darwen Borough Council	5.000	5.000
Cheshire East Council	5.000	5.000
Dundee City Council	5.000	-
Eastleigh Borough Council	-	5.000
Falkirk Council	5.000	5.000
Gateshead Metropolitan Borough Council	5.000	-
Highland Council Inverness	15.000	5.000
Lancashire County Council	15.000	15.000
London Borough of Islington	5.000	5.000
Mid and East Antrim Borough Council	1.600	-
Mid Suffolk District Council		5.000
Newcastle Upon Tyne City Council	10.000	10.000
North Lanarkshire Council	-	5.000
Northumberland County Council	15.000	15.000
Plymouth City Council	7.000	-
Stockport Borough Council	5.000	5.000
Telford and Wrekin Borough Council	4.000	
Non UK Banks		
Australia		
Australia & New Zealand Banking Group	5.000	10.000
Commonwealth Bank of Australia	5.000	5.000
Canada		
Bank of Montreal	-	
Netherlands		
Cooperative Rabobank	15.000	10.000
Singapore		
Development Bank Singapore	12.000	7.000
United Overseas Bank	12.000	15.000
Money Market Funds		
HSBC Global Liquidity Fund Class G MMF	-	-
BNP Paribas Insticash Sterling MMF	8.757	1.840
TOTAL INVESTMENTS	**230.585**	**205.849**

Investment Benchmarking

31 December 2017

	Havering	13 London & Met Boroughs Average	150 LAs Average
Internal Investments	£230.3m	£111.0m	£63.1m
External Funds	£0.0m	£4.6m	£10.2m
TOTAL INVESTMENTS	**£230.3m**	**£117.4m**	**£73.3m**
Security			
Average Credit Score	3.91	4.45	4.51
Average Credit Rating	AA-	AA-	A+
Average Credit Score (time-weighted)	3.67	4.32	4.23
Average Credit Rating (time-weighted)	AA-	AA-	AA-
Number of Counterparties / Funds	28	17	16
Proportion Exposed to Bail-in	30%	56%	61%
Liquidity			
Proportion Available within 7 days	6%	40%	41%
Proportion Available within 100 days	44%	69%	68%
Average Days to Maturity	242	100	41
Market Risks			
Average Days to Next Rate Reset	240	114	71
External Fund Volatility	0.0%	0.3%	2.1%
Yield			
Internal Investment Return	0.65%	0.57%	0.54%
External Funds - Income Return		1.33%	3.41%
External Funds - Capital Gains/Losses		0.67%	0.70%
External Funds - Total Return		2.00%	4.11%
Total Investments - Income Return	0.65%	0.65%	0.92%
Total Investments - Total Return	**0.65%**	**0.73%**	**1.14%**

Notes

- The internal investments figure stated above of £230.3m differs slightly from that stated in Appendix A (£230.5m). The difference is due to a transposition of figures that was spotted later during the monthly reconciliation process.
- Unless otherwise stated, all measures relate to internally managed investments only, i.e. excluding external pooled funds.

- Averages within a portfolio are weighted by size of investment, but averages across authorities are not weighted.
- Credit scores are calculated as AAA = 1, AA+ = 2, etc.
- Volatility is the standard deviation of weekly total returns, annualised.

Appendix C

Compliance Report

All treasury management activities undertaken during the year to Quarter 3 complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

1.1 Interest Rate Exposures

1.1.1 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:

Table1: Interest rate exposure activity

	2017/18 Limit %	2017/18 Q3 Actual %	2018/19 Limit %	2019/20 Limit %
Upper limit on fixed interest rate exposure	100	89	100	100
Upper limit on variable interest rate exposure	25	11	30	35

Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

1.1.2 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. The table excludes Salix Finance loans as these are held at zero interest hence no interest rate exposure.

1.2 Maturity Structure of Borrowing

1.2.1 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 2: Loan maturity structure

	Upper %	Lower %	Actual %
Under 12 months	40	0	8.29
12 months and within 24 months	40	0	3.05
24 months and within 5 years	60	0	0.48
5 years and within 10 years	75	0	8.97
10 years and above	100	0	79.21

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.

1.3 Principal Sums Invested for Periods Longer than 364 days

1.3.1 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.

1.3.2 The limits set in the 2017/18 treasury management strategy in comparison to the quarter one is set below. It is the authority's policy to classify available for sale investments with maturities exceeding one year as short term investments.

Table 3: Investments for periods longer than 364 days

	2017/18 Limit £m	2017/18 Actual £m	2018/19 Limit £m
Limit on principal invested beyond year end	75	45	75

1.4 Liquidity Treasury Indicator

1.4.1 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 4: Liquidity activity as 31/12/2017

	Target £m	Actual £m
Total cash available by the next working day	5.000	8.857
Total cash available within 3 months	30.000	57.000

1.5 Security Treasury Indicator

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

Table 5: Security Treasury Indicator

	31.12.17 Actual	2017/18 Target
Portfolio average credit rating	AA-	A+

1.6 Gross Debt and the Capital Financing Requirement (CFR)

1.6.1 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 CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 6: Gross debt and the CFR Forecast at Quarter 3.

	31.03.17 Actual £m	31.03.18 Estimate £m	31.03.19 Estimate £m	31.03.20 Estimate £m
Long Term External Debt	210.234	210.234	210.234	256.234
CFR	250.578	280.794	325.527	371.890
Internal Borrowing	40.344	70.560	115.293	115.656

1.6.2 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.

1.7 Operational Boundary for External Debt

1.7.1 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 7: Operational Boundary

Operational Boundary	2017/18 £m	31.12.17 Actual	2018/19 £m	2019/20 £m
Borrowing	276.300	229.483	310.600	341.400
Other long-term liabilities	2.000	0.000	2.000	2.000
Total	**278.300**	**229.483**	**312.600**	**343.400**

1.8 Authorised Limit for External Debt

1.8.1 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 8: Authorised limit for external debt

Authorised Limit	2017/18 £m	2018/19 £m	2019/20 £m
Borrowing	303.900	341.700	375.500
Other long-term liabilities	2.000	2.000	2.000
Total Debt	**305.900**	**343.700**	**377.500**
Long Term Debt	210.200	210.200	210.200
Headroom	**95.700**	**133.500**	**133.500**

Glossary of Terms **Appendix D**

A bond is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

A floating rate note (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

Bail in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A **bail**-in is the opposite of a **bail**-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

Certificates of deposit (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

Coupon is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi annually or annually and an FRN will most likely pay every 3 months.

Covered bond Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

Credit rating A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

MIFID is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.

Spread is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.

Monetary Policy Committee (**MPC**) is a committee of the Bank of England, which meets for three and a half days, eight times a year, to decide the official interest rate in the United Kingdom (the Bank of England Base Rate).

CPIH (Consumer Prices Index including owner occupiers' housing costs) The new additional measure of consumer price inflation including a measure of owner occupiers' housing costs (OOH).

Treasury bills (T-bills) are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.