Havering
LONDON BOROUGH

AUDIT COMMITTEE 25 JULY 2019

Subject Heading:	**Annual Treasury Management Report 2018/19**
SLT Lead:	**Jane West** **Chief Financial Officer**
Report Author and contact details:	**Zainab Roberts / Stephen Wild** **Treasury Manager / Head of Pensions and Treasury** **01708 434 306** **Zainab.Roberts@havering.gov.uk**
Policy context:	This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2018/19. This report meets the requirement of both the CIPFA Code of practice on Treasury Management,(the code) and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code)
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).

The Authority's treasury management strategy Statement (TMSS) for 2018/19 was approved at a meeting of the Authority in February 2018 and revisions to the strategy were approved at a meeting of the Authority in November 2018.

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.

RECOMMENDATIONS

- To note the treasury management activities for the financial year 2018-19 detailed in the report.

KEY HIGHLIGHTS

- Investment income for the year was £2m compared to a budget of £1.5m.
- The Authority's weighted average return outperformed that of the treasury adviser's London Local Authority Group.
- During 2018/19 this Council operated within the treasury limits and prudential indicators set out in the Strategy.
- International Financial Reporting Standard (IFRS) 9 came into effect in 2018-19. The expected credit losses are not material as the Authority's investments are placed with highly credit worthy institutions and Local authorities. The Rockfire bond deemed to meet the SPPI (solely principal plus interest) test and treated at amortised cost.

REPORT DETAIL

1. External Context

1.1. Economic Backdrop

After raising the Bank rate to 0.75% in August 2018, the MPC voted unanimously to hold rates in various meetings. The Bank of England predicted a gradual increase in inflationary pressures.

The Authority's treasurer adviser (Link Asset Services) 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. Link predicted that interest rate will be on hold until mid- year 2020.

The increase in Bank Rate resulted in higher money markets rates: 3-month and 12-month LIBID rates averaged 0.73%, 0.98%.

The 50 year PWLB rates for fixed term borrowing were 2.12% and 25 years PWLB at 2.25%. The Authority did not forecast to undertake any additional borrowing in the 2018-19 borrowing strategy. This was kept under review during the year; assessing the need to externally borrow at various times during the course of the year. No long term borrowing was undertaken in the year as it has been cost effective to use internal borrowing or to borrow short term loans.

1.2 Credit Background

As at 31.03.2019 the authority has invested £19.1m in foreign banks are (Rabobank - £5m, United Overseas Bank Ltd - £4.1m, Development Bank Singapore - £5m and Australia and New Zealand Banking Group - £5m). The long term ratings of these institutions are stable outlook except the Rabobank that was downgraded but remains above the Authority's minimum credit quality threshold. Most of the Authority investments are with Local Authorities which do not have credit ratings but have government support. The Authority is currently using three money market funds (MMFs) to manage the day-to-day cash flow requirements which are Insight, Federated Prime rate and Blackrock.

1.3 Financial Instrument Regulations:

IFRS 9 came into effect on 1st April 2018. All the Authority's investments are deemed to meet the SPPI (solely principal plus interest) test and treated at amortised cost.

The new regulation requires measurement of any expected credit loss. As the Authority's investments exceeds minimum credit rating agreed in TMSS, the expected credit loss was deemed to be not material and therefore no adjustment was required to the Authority's accounts.

1.4 Credit Rating developments

The Standard and Poor (S&P) Global Ratings has been upgraded with the Long Term Rating of The Royal Bank of Scotland Group Plc and its core operating subsidiaries e.g. National Westminster Bank. In addition to this, the Outlook on all entities has changed to "Stable" from "Positive".

The upgrade reflects The Royal Bank of Scotland Group plc (RBSG) strengthened credit fundamentals following a long period of restructuring and refocusing. It has addressed the majority of legacy assets and legal risks, maintained a robust capital position, and laid the foundations for improved cost efficiency and earnings. As a result, S&P believe RBSG's creditworthiness is more comparable with peers, and S&P now align its unsupported group credit profile with our 'bbb+' anchor for UK Banks.

Moody's Investor Services (Moody's) has changed the Outlook on the Long Term Rating of Barclays Bank PLC (NRFB) and Goldman Sachs International Bank. At the same time, all ratings were affirmed.

The Positive Outlook on Barclays Bank PLC (NRFB) ratings reflects the progress it has made in its restructuring plan including the de-risking of its balance sheet, which will lead to higher profits and an improved capital position.

Moody's said the ratings affirmation reflects Goldman Sachs's strengthened capital ratios, its continued resilient profitability, aided by strong cost discipline, and an expected gradual reduction in the firm's reliance on wholesale funding as it continues to grow its deposit business.

As explained in the Treasury Management Strategy Statement (TMSS), investment decisions are made by reference to the lowest published long term credit rating from Fitch, Moody's or Standard & Poor's ratings agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

2. Treasury Management Summary

The treasury management position as at 31st March 2019 and the change over the period is shown in table 1 below.

Table 1: Treasury Management Summary as at 31st March 2019

	31.3.18		31.03.19	31.03.19
	Balance	Movement	Balance	Average Rate
	£m	£m	£m	%
Long-term borrowing	210.234	-	210.234	3.60
Short-term borrowing	30.252	(29.901)	0.351	0.38
Total borrowing	**240.486**	**(29.901)**	**210.585**	**3.59**
Long-term investments	33.000	5.000	38.000	1.61
Short-term investments	150.850	(16.750)	134.100	0.95
Cash and cash equivalents	44.739	(30.249)	14.490	0.77
Total investments	**228.589**	**(41.999)**	**186.590**	**1.07**
Net borrowing	**11.897**	**12.098**	**23.995**	**2.52**

3. Borrowing Strategy

3.1 The 31st March 2019 borrowing position is shown in table 2 below.

Table 2: Borrowing Position

	Balance at 01/04/18 £m	Raised £m	Repaid £m	Balance at 31/03/19 £m	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)	30.252	0.100	(30.000)	.352	**0.38**
Total Loans	**240.486**	**0.100**	**(30.000)**	**210.586**	**3.59**

As illustrated in Tables 1 & 2 above long term investments have remained below £200m generating a lower return in comparison to the average cost of long term borrowing. It has been cost effective to use internal resources to fund unfinanced capital expenditure incurred in 2018/19.

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 financial year is shown in Table 3 below.

4.2 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

	31.3.18 Balance	Movement	31.03.19 Balance	Average Rate %
Investments				
Banks & Building Societies (Fixed Unsecured)	49.000	(14.900)	34.100	0.99
Banks & Building Societies (Call & Notice Accounts Unsecured)	23.202	1.798	25.000	0.93
Banks & Building Societies (Fixed Secured)	8.800	(7.800)	1.000	1.22
Government (incl. Local Authorities)	131.850	(22.850)	109.000	1.09
Money Market Funds	12.737	1.753	14.490	0.77
Corporate Bonds and Loans	3.000	-	3.000	4.00

4.3 At 31 March 2019, the Authority's risk adjusted return was higher than the average for 14 London Boroughs in the LINK benchmarking club. The Authority's average return on investments was 0.92% compared to an average return of 0.90% on internally managed investments within the Link benchmarking club.

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

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: Treasury Investment Performance during the year 2018-19

	Benchmark Return 3 month LIBOR (Average Quarterly Rate) %	Budgeted Rate of Return %	Budgeted Interest (Full Year) £m	Weighted Actual Rate of Return %	Actual Interest to end of Quarter £m
Quarter 1	0.68	0.60	1.500	0.81	0.449
Quarter 2	0.78	0.60	1.500	0.88	0.495
Quarter 3	0.80	0.60	1.500	0.98	0.548
Quarter 4	0.80	0.60	1.500	1.00	0.540
Total			**1.500**	**0.92**	**2.032**

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 Interest rate forecasts expected only gradual rises in medium and longer term borrowing rates during 2018/19, and the two subsequent financial years. Variable or short-term rates were expected to be the cheaper form of borrowing over the period.

6.3 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 B** 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

None

Appendix A

Table 1 breakdown of Deposits at 31st March 2019

Institution Type	31st March 2019 Actual £m	31st December 2018 Actual £m
UK Banks		
Goldman Sachs INT"L Bank	5.000	15.000
Lloyds Bank PLC	15.000	10.000
Close Brothers Ltd		5.000
National Westminster Bank Plc		.100
Santander UK PLC	20.000	20.000
Santander UK PLC (Covered Bond)	1.001	1.001
Local Authorities & Other Public Sector		
London Borough of Haringey	4.000	4.000
London Borough of Croydon	5.000	5.000
Slough Borough Council	5.000	5.000
Dorset County Council		5.000
Dundee City Council	5.000	5.000
Telford and Wrekin Borough Council	5.000	5.000
Gateshead Metropolitan Borough Council	5.000	5.000
Highland Council Inverness	5.000	5.000
Lancashire County Council	5.000	5.000
Lincoln City Council		1.750
London Borough of Islington	5.000	5.000
London Borough of Barnet	5.000	5.000
Newcastle Upon Tyne City Council	10.000	15.000
Woking Borough Council	5.000	5.000
Northumberland County Council	10.000	10.000
Plymouth City Council	10.000	10.000
Powys County Council	5.000	5.000
Cambridgeshire County Council	5.000	5.000
Mid Suffolk District Council	5.000	5.000
Eastleigh Borough Council	10.000	10.000
Non UK Banks		
Australia		
Australia & New Zealand Banking Group	5.000	5.000
Netherlands		
Rabobank Nederland	5.000	5.000
Singapore		
Development Bank Singapore	5.000	10.000
United Overseas Bank	4.100	4.100
Money Market Funds		
BNP Paribas Insticash Sterling MMF		7.600
Federated Prime Rate Sterling Liquidity 3	5.500	1.900
Insight Liquidity Sterling C3	8.990	
Unrated Corporate Bonds		
Rockfire Capital Ltd	3.000	3.000
TOTAL INVESTMENTS	**186.590**	**208.451**

Appendix B

Compliance Report

All treasury management activities undertaken during the financial year 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

	2018/19 Limit %	2018/19 Actual %	2019/20 Limit %	2020/21 Limit %
Upper limit on fixed interest rate exposure	100	96.60	100	100
Upper limit on variable interest rate exposure	25	3.40	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	0
12 months and within 24 months	60	0	3.86
24 months and within 5 years	80	0	0
5 years and within 10 years	100	0	34.75
10 years and above	100	0	61.39

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 2018/19 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

	2018/19 Limit £m	2018/19 Actual £m	2019/20 Limit £m
Limit on principal invested beyond year end	75	38	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 at 31/03/2019

	Target £m	Actual £m
Total cash available by the next working day	5.000	14.490
Total cash available within 3 months	30.000	67.800

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

	31.03.19 Actual	2018/19 Target
Portfolio average credit rating	A+	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 at 31st March 2019

	31.03.19 Actual £m	31.03.20 Estimate £m	31.03.21 Estimate £m	31.03.22 Estimate £m
Long-term External Debt	**210.234**	**210.234**	**210.234**	**256.234**
General Fund	67.797	104.693	130.435	138.063
Housing HRA	174.669	212.660	254.784	284.808
Regeneration Prog.	30.877	122.537	173.897	212.414
TOTAL CFR	**273.343**	**439.890**	**559.116**	**635.285**
Internal Borrowing	63.109	229.656	348.882	379.051

1.6.2 Total debt is expected to remain below the CFR. Actual debt levels are monitored against the Operational Boundary and authorised Limit for External Debt as 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. These limits may be reviewed as part of mid-year TMSS report in the event of a change in the interest rate outlook and the decision is made to fund the increase in CFR from external debt.

Table 7: Operational Boundary

Operational Boundary	2018/19 £m	31.03.19 Actual	2019/20 £m	2020/21 £m
Borrowing	385.000	210.234	423.000	436.000
Other long-term liabilities	10.000	0.000	10.000	10.000
Total	**395.000**	**210.234**	**433.000**	**446.000**

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 borrow. The authorised limit provides headroom over and above the operational boundary for unusual cash movements

Table 8: Authorised limit for external debt

Authorised Limit	2018/19 £m	2019/20 £m	2020/21 £m
Borrowing	414.000	472.000	487.000
Other long-term liabilities	10.000	10.000	10.000
Total Debt	**424.000**	**482.000**	**497.000**
Long Term Debt	210.234	210.234	210.234
Headroom	**213.766**	**271.766**	**286.766**

IMPLICATIONS

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.
The Treasury Management Annual Report is a requirement of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. Local Authorities are required by regulation to have regard to both codes when carrying out their duties in England and Wales under Part 1 of Paragraph 1 of this report confirms that this report has been produced in accordance with both codes.

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

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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.