AUDIT COMMITTEE **28th January 2020**

Subject Heading:	**TREASURY MANAGEMENT MID YEAR UPDATE 2019-20**
SLT Lead:	**Jane West** **Chief Operating Officer**
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Policy context:	**The Code of Practice on Treasury Management (Revised 2017) requires that Council be provided with a mid-year report on treasury activities.**
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

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The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code ("TM Code") require authorities to report on treasury management activities to Full Council at least twice per year (mid-year and at year end).

The Authority's Treasury Management Strategy Statement (TMSS) for 2019-20 was approved at a meeting of the Authority in February 2019.

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.

The key highlights of the Mid-Year report are as follows:

- At the end of December investment portfolio return was 1.068% outperforming the LINK benchmarking Group average of 0.98% and the authority's Budgeted rate of return of 0.80% against a backdrop of falling 3 month LIBOR.

- Gilt yields are currently low but on the 9th October the HM Treasury increased the current margin over gilt by 100bp (one percentage point). This was a policy decision by the Government directed at reducing the unprecedented growth in PWLB borrowing. London Local authorities have campaigned for the decision to be reversed. While the outlook on interest rates remains benign and the market is starting to develop cheaper alternatives to the PWLB, officers will continue to fund the authority's capital financing requirement from cheaper internal borrowing. In 2019-20 the Authority's investment income budget of £1.7m is set to be exceeded.

- There was no breach of the Authority's prudential indicators and treasury indicators.

RECOMMENDATIONS

- To note the treasury management activities to December 2019 are detailed in the report.

REPORT DETAIL

1. Background

Treasury management

1.1 The authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

1.2 The other main function of authority's treasury management operation is to help fund its capital plans. These capital plans provide a guide to the borrowing need of the authority, essentially the longer term cash flow planning required to meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Capital Strategy

1.3 In December 2017, CIPFA published revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities were required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

1.4 A report setting out our Capital Strategy will be taken to the full council, (or cabinet, with responsibility retained by the full council), before 31st March 2020.

2. Introduction

2.1 This report has been written in accordance with the requirements of the CIPFA TM Code.

2.2 This is the Mid-Year Review Report required by the TM Code and covers the following:

- an economic update for the first part of the 2019/20 financial year

- Treasury Management Summary to December 2019
- a review of the authority’s borrowing strategy for 2019/20
- a review of the authority’s investment portfolio for 2019/20; and
- a review of compliance with Treasury and Prudential Limits for 2019/20.

3. Economics and interest rates

Economics update

3.1 The Bank of England Monetary Policy Committee (“MPC”) has held its main interest rate steady at 0.75% with its rate-setting committee voting 7-2 in favour of keeping the current level.

The central bank maintained the dovish stance exhibited after its previous meeting, commenting in an accompanying statement: “If global growth fails to stabilize or Brexit uncertainties remain entrenched, monetary policy may need to reinforce the expected U.K. recovery.”

Its forecast for U.K. GDP (gross domestic product) growth in the fourth quarter of 2019 was cut to +0.1% from the November forecast of +0.2%, reflecting the weakening of economic conditions shown in recent data.

Two MPC policymakers, Jonathan Haskel and Michael Saunders, voted to cut the main interest rate to 0.5%, as was also the case in November.

On the U.S.-China trade war, the Bank of England noted the “partial de-escalation of the U.S.-China trade war gives some additional support to the outlook” but highlighted that the continued sign of loosening in the U.K. labour market was another potential headwind.

The central bank has been grappling with uncertainty over Brexit for the past three years, and their focus now switches to what kind of trade deal the the U.K will negotiate with the EU.

Following the Conservative Party’s election victory, which all but ensures the U.K. will leave the EU before the January 31 deadline, Prime Minister Johnson has vowed to block any extension to the post-exit transition period beyond the end of 2020.

Interest rate forecasts

3.2 The authority’s treasury advisor, Link Asset Services (LAS), has provided the following forecast in table 1 below:

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Table 1: Interest Rate forecast

Bank Rate

	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
Capital Economics	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	-	-	-	-	-

5yr PWLB Rate

	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	2.20%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	2.20%	2.40%	2.50%	2.50%	2.60%	2.60%	2.80%	2.80%	2.90%	-	-	-	-	-

10yr PWLB Rate

	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	2.44%	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	2.44%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	-	-	-	-	-

25yr PWLB Rate

	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	3.00%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	3.00%	3.10%	3.10%	3.20%	3.20%	3.20%	3.30%	3.30%	3.40%	-	-	-	-	-

50yr PWLB Rate

	NOW	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	2.85%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	2.85%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	-	-	-	-	-

4. Treasury Management Summary

4.1 The treasury management position as at 31st December 2019 and the change over the period is shown in table 2 below.

Table 2: Treasury Management Summary as at 31st December 2019

Investment Activity

	01.04.19 Balance	**Movement**	**31.12.19 Balance**	**Weighted Average Rate %**
Investments				
Fixed Deposit	138.100	-8.100	130.000	1.09
Money Market Funds	34.060	-23.180	10.880	0.73
Call Account	25.000	-10.000	15.000	0.90
Covered Bonds	4.000	-1.000	3.000	4.00
Total investments	**201.160**	**-42.280**	**158.880**	**1.10**

4.2 The authority's investments as at 31st December 2019 stood at £158.8m – consisting of £85m with local authorities, £68.8m with UK banks and £5m with non UK banks.

4.3 Appendix A shows the breakdown of the authority's investments.

4.4 Table 4 below shows the treasury investment performance for quarter ending 31st December 2019.

5. Borrowing Strategy

Borrowing Position

5.1 The 31st December 2019 borrowing position is shown in table 3 below.

Table 3: Borrowing Position

	Balance at 01.04.19 £m	Raised £m	Repaid £m	Balance at 31.12.19 £m	Weighted Average Rate %
Loans					
PWLB	203.234	-	-	203.234	**3.60**
Banks (LOBO)	7.000	-	-	7.000	**3.60**
Temporary Borrowing	0.351	15.000	-	15.351	**0.85**
Total Loans	**210.585**	**15.000**		**225.585**	**3.40**

5.2 The authority's capital financing requirement (CFR) for 2019/20 was forecast at £375m. The CFR denotes the Authority's underlying need to borrow for capital purposes. The Authority can borrow up to the CFR from PWLB or the market (external borrowing).

New borrowing

5.3 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.

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5.5 The gilt yields have been at their lowest but without warning on the 9th October 2019 PWLB increased the margin that applies to new borrowing from one to 2 percentage points with immediate effect.

As a result no long term borrowing has been undertaken in the year to date, but this will be kept under continuous review as capital investment plans are developed and spending is monitored.

Debt Rescheduling

5.6 The possibility of debt rescheduling is regularly discussed with our treasury adviser and is a regular agenda item at the quarterly treasury meeting held between the treasury officers, LAS, the S151 officer and the lead Member for Financial Management. However opportunities have been almost non-existent in the current economic climate.

LOBO's

5.7 The Authority holds a £7m LOBO loan, where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost.

6.0 Budgeted Income and Return

6.1 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: 2019-20 Treasury Investment Performance to 31st December 2019

Period	Benchmark Return 3 month LIBOR (Average Quarterly Rate)	Budgeted Rate of Return %	Actual Rate of Return %	Investment Interest earned to Period end £m
Quarter 1	0.77	0.80	1.05	0.535
Quarter 2	0.75	0.80	1.06	0.519
Quarter 3	0.76	0.80	1.07	0.469
Average / Total				1.523

6.2 As shown in table 4, the authority outperformed its benchmark in all quarters. This was achieved by locking into longer term deposits to mitigate the impact of a falling 3 month LIBOR. However once these investments matured the cash becomes subject to current market rates.

6.3 It is expected that the average 3 months LIBOR will drop further and as maturing deposits are replaced with new investments at lower rates any excess interest in year may be eroded before the end of the financial year. Officers and LAS will consider reinvesting in longer duration investments (exceeding 364 days) and locking investments into forward deals to obtain higher yield (within existing risk parameters) subject to the authority's cash flow plan.

7.0 Current Investment Opportunities

7.1 The Authority is occasionally made aware of long term investment opportunities by other oneSource Authorities, brokers or investment advisers.

7.2 Cabinet on the 13th February 2019 approved changes to the Treasury Management Strategy Statement (TMSS) which facilitate investment in a wider range of products.

8.0 Money Market Fund Regulation (MMF)

8.1 Money Market Funds (MMFs) are an important source of short-term financing for financial institutions, corporates and governments.

8.2 On 30 June 2017, the MMFs regulation was published in the Official Journal of the EU. This regulation has two key objectives:

- Enhance financial stability within European markets by preventing the risk of contagion potentially transmitted by the "run" of MMFs to money markets and to their sponsors (mainly financial institutions)
- Increase investor protection by reducing the disadvantages for late redeemers in stressed market conditions.

8.3 This regulation introduces:

- New risk management requirements which impose stress testing and internal processes to determine credit quality for money market instruments, and "Know Your Customer" policies and procedures.

- New liquidity management requirements for Public Debt Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) MMFs. External support to guarantee the liquidity of an MMF or to stabilise its NAV are prohibited.

- These provide transparency requirements to investors and competent authorities.

So what does this all mean for Havering – have we using LVNAF MMFs now are we changing our specified investments?

9. Local Authority Lending

9.1 Over the last few years inter Local Authority lending and borrowing activity has gradually been increasing within the money markets. Whilst Local Authorities cannot provide a formal guarantee nor have the power to offer security they are required by statute to repay debt first out of revenues, before any spend, which is usually sufficient to give quasi UK Government ratings.

9.2 However over the last decade Local Authorities have faced significant financial pressures due to constant cuts in government funding on one hand and increasing demographic pressures on the other. Officers set overlay limits on lending to specific local authorities and where there are concerns then we may choose to remove them from our lending list.

9.3 LAS central view is that all local authorities have the same credit risk as the mechanisms that exist within the local authority legislative framework effectively prevent a local authority from going bankrupt.

This is reinforced by a statement from the National Audit Office, entitled Financial Sustainability of Local Authorities, dated November 2014, which states that:

“A legal framework at the core of the local government accountability system effectively prevents local authorities becoming insolvent. Local authorities cannot borrow to finance revenue expenditure or run deficits.”

10.0 Changes in risk appetite

10.1 The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to members’ attention in treasury management update reports.

11.0 Compliance with Prudential and Treasury Indicators

11.1 It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. The Authority's approved 2019/20 Treasury and Prudential Indicators (affordability limits) were included and approved by Full Council as part of the TMSS in February 2019.

11.2 During the half year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority TMSS 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 December 2019

Institution Type	1st April 2019 Actual £'m	31st December 2019 Actual £'m
UK Banks		
Goldman Sachs INT"L Bank	5.000	15.000
Lloyds Bank PLC	15.000	25.000
Santander UK PLC	20.000	15.000
Local Authorities & Other Public Sector		
Powys County Council	5.000	5.000
Lancashire County Council	5.000	5.000
Cambridgeshire County Council	5.000	5.000
Mid Suffolk District Council	5.000	5.000
London Borough of Haringey	4.000	
London Borough of Croydon	5.000	5.000
Gateshead Metropolitan Borough Council	5.000	
London Borough of Islington	5.000	5.000
Slough Borough Council	5.000	5.000
Newcastle Upon Tyne City Council	5.000	5.000
Northumberland County Council	10.000	10.000
Plymouth City Council	10.000	
Highland Council	5.000	
Telford and Wrekin Borough Council	5.000	
Dundee City Council	5.000	
Woking Borough Council	5.000	
London Borough of Barnet	5.000	
London Borough of Southwark		5.000
London Borough of Enfield		5.000
Eastleigh Council	5.000	
Warrington Borough Council		5.000
Aberdeenshire Council		5.000
Dunbartonshire Council		5.000
Salford City Council		5.000
Guildford Borough Council		5.000
Non UK Banks		
Australia		
Australia & New Zealand Banking Group	5.000	5.000
Netherlands		
Cooperative Rabobank	5.000	
Singapore		
Development Bank Singapore	5.000	
United State of America		
United Oversea Bank Ltd	4.100	
Money Market Funds		
Blackrock	4.060	
Federated Liquidity Sterling	15.000	7.820
Insight Investments Liquidity	15.000	3.060
Bond		

Rockfire capital Ltd	3.000	3.000
Covered Bond		
Santander (Floating rate note)	1.000	
TOTAL INVESTMENTS	**201.160**	**158.880**

Appendix B

Compliance Report

All treasury management activities undertaken during the half 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

	2019/20 Limit %	2019/20 Q3 Actual %	2020/21 Limit %	2021/22 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	6.65
12 months and within 24 months	60	0	0.00
24 months and within 5 years	80	0	0.49
5 years and within 10 years	100	0	25.06
10 years and above	100	0	67.80

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 365 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 2019/20 treasury management strategy in comparison to the half year are 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 365 days

	2019/20 Limit £m	**2019/20 Actual 31.12.19 at £m**	**2020/21 Limit £m**
Limit on principal invested beyond year end	75	12.5	75

1.4 Gross Debt and the Capital Financing Requirement (CFR)

1.4.1 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 4: Gross debt and the CFR

	31.03.19 Actual £m	31.03.20 Original Estimate £m	31.03.21 Revised Estimate £m	31.03.22 Estimate £m
Long Term External Debt	210.234	210.234	210.234	210.234
CFR	273.343	439.890	559.116	635.285
Internal Borrowing	63.109	229.505	348.882	425.051

1.4.2 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.

1.5 Operational Boundary for External Debt

1.5.1 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 5: Operational Boundary

Operational Boundary	**2019/20 £m**	**2020/21 £m**	**2021/22 £m**
Borrowing	423.000	436.000	468.000
Other long-term liabilities	10.000	10.000	10.000
Total	433.000	446.000	478.000

1.6 Authorised Limit for External Debt

1.6.1 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 6: Authorised limit for external debt

Authorised Limit	**2019/20 £m**	**2020/21 £m**	**2021/22 £m**
Borrowing	472.000	487.000	520.000
Other long-term liabilities	10.000	10.000	10.000
Total Debt	472.000	497.000	530.000
Long Term Debt	210.385	210.385	210.385
Headroom	**261.615**	**286.615**	**319.615**

Glossary of Terms — Appendix C

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.

LIBOR?

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.

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.