Brent	**Cabinet** 16 November 2015 **Report from the Chief Finance Officer**
2015/16 Mid–Year Treasury Report	

1. SUMMARY

1.1 This report updates Members on recent treasury activity.

2. RECOMMENDATION

2.1 The Committee is asked to note the 2015/16 mid-year Treasury report which has been seen by the Audit Committee and is also to be submitted to the Council.

3. DETAIL

BACKGROUND

3.1 The Council's Treasury Management Strategy is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

3.2 The Code also recommends that Members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

3.3 Treasury Management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.4 In addition to reporting on risk management, the Code requires the Authority to report on any financial instruments entered into to manage treasury risks.

ECONOMIC BACKGROUND

3.5 Growth rates in most major economies looked more fragile in the last six months. The US continues to grow slowly and the Eurozone as a whole has started to experience slow growth. However, Eurozone growth continues to be fragile, and vulnerable to external shocks. The UK is now growing comparatively quickly (0.7% growth in the second quarter of 2015) although balanced growth is still to be delivered. Although business investment rose in the last quarter and there are now signs that productivity may be starting to recover, this is a recent development and the trend is far from established. Both the current account and trade deficits continue to be a source of concern. There is concern that recent developments in China will have international implications, particularly for developing and commodity supported economies.. Inflation in the UK remains at a very low level, with the Consumer Price Index currently growing at 0.1% per annum.

3.6 Gilt yields fluctuated in response to international events in the first half of the year with a slight upward trend. There is continuing uncertainty about when the Federal Reserve and Bank of England will start to unwind Quantitative Easing or increase interest rates, but it is likely that falls in Stock Markets in recent weeks have made the authorities more cautious. The movement in rates at which local authorities can borrow from the Public Works Loans Board (PWLB) is set out in the table below (certainty rates):

Period	March 2015	August 2015
1 year	1.2%	1.3%
5 year	1.9%	2.1%
10 year	2.5%	2.7%

3.7 The interest rate the Council receives on money market funds or for 1-12 month maturities with local authorities has changed little during the first half of the year at 0.45%.

DEBT MANAGEMENT

3.8 The Authority continues to qualify for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate). This is reviewed on an annual basis and has been confirmed as applying until 31 October 2015.

3.9 Alternative sources of long term funding to long-dated PWLB borrowing are available, but the Council will continue to adopt a cautious and considered approach to funding from the capital markets as the affordability, simplicity and ease of dealing with the PWLB represents a strong advantage. No long term loans have been raised so far this year as is shown in the table below:

	Balance on 01/04/2015 £m	Debt £m	New Borrowing £m	Balance on 31/08/2015 £m
Short Term Borrowing	0.0	0.0	0.0	0.0
Long Term Borrowing	423.7	1.6	0.0	422.1
TOTAL BORROWING	423.7	1.6	0.0	422.1
Average Rate %	4.72			4.73

3.10 Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

3.11 For the Council the use of internal resources in lieu of borrowing has continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing both external debt and temporary investments. However this position will not be sustainable over the medium term and the Council will need to give careful consideration to its future capital programme and how this is financed in due course. Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor, Arlingclose.

3.12 The persistence of low interest rates means that it would be uneconomic to reschedule debt, because early retirement of the loan would incur a heavy penalty, to compensate the PWLB for having to lend the money on at lower rates. For example, our most expensive loan, maturing in 6 years, was taken out in 1994, at a rate of 8.875%. There is £3.05m outstanding on this loan. Early repayment would trigger debt redemption charges of £1.28m. If the loan was replaced on a like for like basis, interest charges would be lower. However, the lower interest charges combined with the £1.28m redemption charge (amortised over the life of the loan) would result in an annual charge some £21k higher than the current annual payment. This shows that the current market conditions are some distance away from facilitating effective debt redemption

INVESTMENT ACTIVITY

3.13 The Council gives priority to security and liquidity and aims to achieve a yield commensurate with these principles.

	Balance on 01/04/2015 £m	Investments Made £m	Investments Repaid £m	Balance on 31/08/2015 £m
Short Term Investments	149.1	545.3	506.2	188.2

3.14 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16. New investments were made with the following classes of institutions:

A- rated banks;
AAA rated Money Market Funds;
Other Local Authorities;
The UK Debt Management Office.

3.15 Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, Standard & Poors and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms; potential support from a well-resourced parent institution; share price. At the beginning of the year, there were no foreign banks on our Lending List. Since then, two conservatively run Scandinavian banks with good ratings and strong financial figures have been added to the list. All investments in banks and Building Societies are now undertaken by means of marketable instruments (Certificates of Deposit, CDs). This adds a measure of additional liquidity without sacrificing return, given our maturity limits.

BUDGETED INCOME AND OUTTURN

3.16 The Council's external interest budget for the year is £23.3m, and for investment income is £1.4m and the latest estimate is that the Council will achieve these figures. The average cash balances, representing the Council's reserves and working balances, were £183m during the period to 31 August

3.17 The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until 2016. Short-term money market rates have remained at very low levels.

ICELANDIC BANK INVESTMENT UPDATE

3.18 The Council received £0.4m in August 2015, which means that only £0.2m of the original £10m deposit now remains outstanding. It is expected that a further distribution will be made but this depends on the result of litigation currently under way regarding a property investment.

COMPLIANCE WITH PRUDENTIAL INDICATORS

3.19 Officers confirm that they have complied with its Prudential Indicators for 2015/16, which were set in February 2015 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

OUTLOOK

3.20 At the time of writing this activity report in August 2015, economic growth remains slow worldwide, though the UK has performed comparatively well. Growth has been led by consumer spending, though investment has begun to grow. Productivity remains low though is also showing some signs of improving. However, the current account deficit remains a problem and will continue to do so as long as Eurozone demand remains depressed. Growth prospects outside the UK do not give cause for hope that it will improve soon. A significant threat to world growth is the situation in China and contagion to other emerging economies, which are being squeezed by continued weakness in their currencies, as well as a dearth of demand drivers. The outlook is for official interest rates to remain unchanged into the next financial year, and recent developments are unlikely to bring forward the date for the first. The Council's advisers expect gilt yields to rise slowly over the next two years. Markets will continue to be affected by the potential for a Greek sovereign default and the ramifications of the slowing growth in China.

SUMMARY

3.21 In compliance with the requirements of the CIPFA Code of Practice this report provides Members with a summary report of the treasury management activity during the first half of 2015/16. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

4. FINANCIAL IMPLICATIONS

These are covered in the report.

5 DIVERSITY IMPLICATIONS

None.

6. STAFFING IMPLICATIONS

None.

7 LEGAL IMPLICATIONS

None.

8 BACKGROUND

Annual Treasury Strategy – Report to Full Council as part of the Budget Report – February 2015.

Persons wishing to discuss the above should contact Chris Thompson Treasury and Pension Investments Section, Finance, on 020 8937 1474 at Brent Civic Centre.

CONRAD HALL
Chief Finance Officer

Appendix 1

Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2015/16 to 2017/18 are shown in the table below (excluding Private Finance Initiative schemes):

	31/03/2015 Actual £m	31/03/2016 Estimate £m	31/03/2017 Estimate £m	31/03/2018 Estimate £m
CFR	579	577	567	567

Usable Reserves

Estimates of the Council's level of Usable Reserves for 2015/16 to 2017/18 are as follows:

	31/03/2015 Actual £m	31/03/2016 Estimate £m	31/03/2017 Estimate £m	31/03/2018 Estimate £m
Usable Reserves	97	88	85	84

Prudential Indicator Compliance

Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Authorised Borrowing Limit. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was set at £750m for 2015/16. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2015/16 was set at £650m. The Chief Finance Officer confirms that there were no breaches to the Authorised Limit or the Operational Boundary so far this year; borrowing at its peak was £466m.

Upper Limits for Fixed Interest Rate and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2015/16	Maximum during 2015/16
Upper Limit for Fixed Rate Exposure	100%	100%
Upper Limit for Variable Rate Exposure	40%	0%

Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 31/08/15 £m	% Fixed Rate Borrowing as at 31/08/15	Compliance with Set Limits?
Under 12 months	40	0	41	10	Yes
12 months and within 24 months	20	0	33	8	Yes
24 months and within 5 years	20	0	44	10	Yes
5 years and within 10 years	60	0	18	4	Yes
10 years and above	100	0	288	68	Yes

Net Debt and the CFR

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

The Authority had no difficulty meeting this requirement so far in 2015/16, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Total principal sums invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

The limit for 2015/16 was set at £20m.

The Council's practice since the onset of the credit crunch in 2007 has generally been to keep investment maturities to a maximum of 12 months. At 30 September, the last maturity date in the deposits portfolio was 11 March, 2016.

Credit Risk

This indicator has been incorporated to review the Council's approach to credit risk. The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not the sole feature in the Authority's assessment of counterparty credit risk. The authority considers the following tools to assess credit risk, with advice and support from our advisers, Arlingclose:

- Published credit ratings of the financial institution and its sovereign;
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum.

The Council can confirm that all investments were made in line with a minimum long term credit rating of A- or equivalent, as set in the 2015/16 TMSS.

HRA Limit on Indebtedness

This purpose of this indicator is for the Council to report on the level of the limit imposed at the time of implementation of self-financing by the Department for Communities and Local Government.

HRA Limit on Indebtedness	31/03/2015 Actual £m	31/03/2016 Estimate £m	31/03/2017 Estimate £m	31/03/2018 Estimate £m
HRA CFR	137	137	137	137
HRA Debt Cap (as prescribed by CLG)	199	199	199	199
Difference	62	62	62	62