Brent	**Audit Advisory Committee** 20 September 2017 **Report from the Chief Finance Officer**
For information	Wards Affected: All
2017/18 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 2017/18 mid-year Treasury report, which is to be forwarded to the Cabinet and 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 in the UK economy has slowed in 2017 with both the US and Eurozone now growing at around twice that of the UK. The most recent estimate for UK GDP growth is 0.3% for Q2 with the Eurozone and US running at 0.6%. Arlingclose have advised that the outlook for the UK economy remains challenging to predict following the vote to leave the European Union. Mark Carney, Bank of England governor, after the decision to keep interest rates at 0.25%, referred to uncertainty around the Brexit process "*weighing on the decisions of businesses*".

3.6 One of the key drivers of the UK economy, consumer spending, has weakened as the effects of inflation out pacing wages starts to take hold. The weakness of the pound has been source of inflationary pressure however our treasury advisors noted that it is unlikely to result in the tightening of monetary policy by the Bank of England with a view to minimise the effects of Brexit on economic activity.

3.7 Gilt yields have fluctuated in response to domestic and international events in the first half of the year. The movement in rates at which local authorities can borrow from the Public Works Loans Board (PWLB) on maturity loans is shown in the table below:

PWLB Rates

Period	March 2017	August 2017
1 year	1.0%	1.1%
5 year	1.5%	1.4%
10 year	2.1%	2.1%

3.8 The interest rate the Council receives on money market funds has fallen since the previous report and 12 month maturities with local authorities have fallen from 0.6% to 0.4%.

DEBT MANAGEMENT

3.9 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 2017.

3.10 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. The affordability, simplicity and ease of dealing with the PWLB represents a strong advantage but the Council, due to its prudent policies and strong balance sheet, is in a position to consider alternatives, and will start to do so in order to finance the investment strategy. However, no new long term loans have needed to be raised so far this year as can be seen in the table below:

	Balance on 01/04/2017 £m	Debt repaid* £m	New Borrowing £m	Balance on 31/08/2017 £m
Short Term Borrowing	0.0	0.0	0.0	0.0
Long Term Borrowing	415.0	1.6	0.0	413.4
TOTAL BORROWING	415.0	1.6	0.0	413.4
Average Rate %	4.79	2.57		4.81

* £28.5m of the PWLB loans are referred to as EIP, whereby the Councils pays down the loans in half-yearly equal installments over the lifetime of the loan. The marginal increase in the average interest rate can be attributed to the Council paying back its EIP loans. This is because the EIP loans have a much lower interest average interest rate of 2.57% compared with the rest of the debt, which is 4.98%

3.11 Affordability remains an important influence on the Council's borrowing strategy. Moreover, any borrowing undertaken ahead of need would need to be invested in the money markets at rates of interest significantly lower than the cost of borrowing and involve credit risk. If interest rates seemed likely to rise in the short-term then this approach might need to be reviewed.

3.12 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 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. Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor, Arlingclose.

3.13 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, the Council's most expensive loan is £3.05m at a rate of

8.875%, to repay it would cost £0.935m, a 30% premium on the value of the loan before the cost of re-financing. In short, the cost of re-financing our loans under the Government's approach means is not economical. This analysis might change if interest rates returned to historically normal levels.

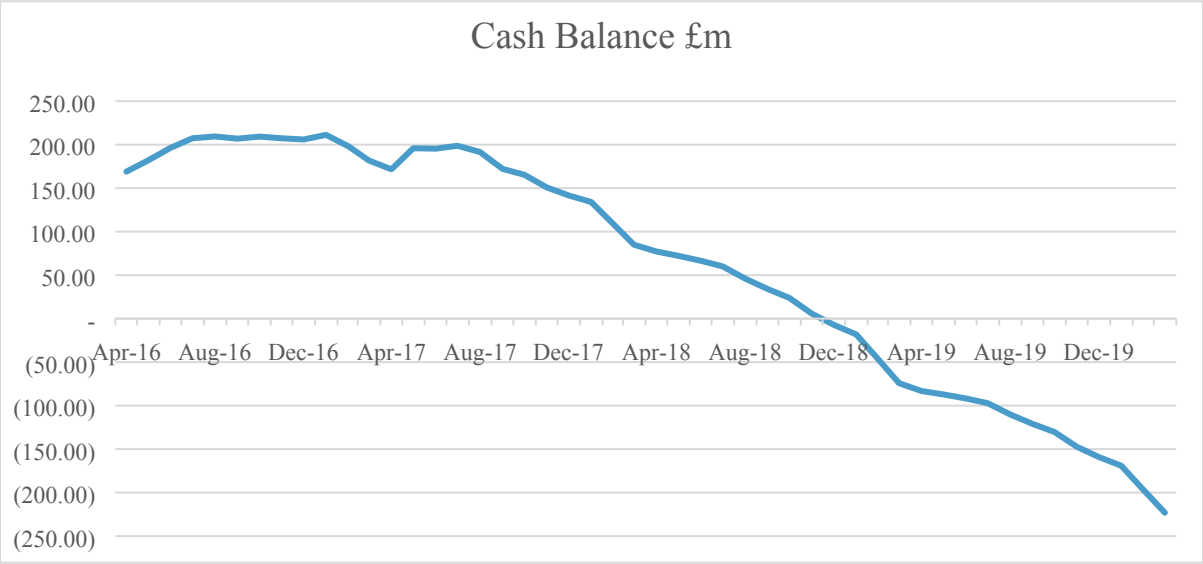
INVESTMENT ACTIVITY

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

	Balance on 01/04/2017 £m	Investments Made £m	Investments Repaid £m	Balance on 31/08/2017 £m
Short Term Investments	167.3	499.9	492.1	175.1

3.15 There was a £7m upward movement in short-term investments. This is due to a natural pattern of growth in cash in the early part of the year as grant income is frontloaded. However, it is far lower than the £42m upward movement last year, as already purchases of properties (NAIL, PRS and HRA) is having a significant impact on our cashflows with over £25m spent to date. The remainder is made up of higher spend across the Capital Programme. £199m was the average amount of cash held in 2016/17.

3.16 The council has undertaken a preliminary analysis of its cash flows, examining the pace at which we are reducing our cash reserves, The analysis was based on forecast capital spend, incoming resources and seasonal variations. This resulted in a prediction that the council will need to borrow towards the end of 2018, limiting our ability to use financial products that generate higher financial returns, as they would require longer time horizons. The council is reviewing its borrowing options which may include short term loans, PWLB borrowing or market loans. The council will also consider the advice of our Treasury management advisors, Arlingclose prior to any borrowing decision being made.



3.17 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2017/18. New investments were made with the following classes of institutions:

A- or above rated banks;
AAA rated Money Market Funds;
Other Local Authorities;

3.18 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 & Poor's 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. There were two foreign banks on our Lending List, both Swedish (and, therefore, outside the Eurozone), conservatively run and with good ratings and strong financial figures.

3.19 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

3.20 The Council's external interest budget for the year is £23.3m, and for investment income is £1.4m. The Council is unlikely to achieve the income figure, but this will be compensated for by lower borrowing costs than budgeted. The average cash balances, representing the Council's reserves and working balances, were £191m during the period to 31 August 2017.

3.21 The UK Bank Rate reduced to 0.25% on 4 August 2016 and has not increased since then. Short-term money market rates have remained at very low levels and do not, at the moment, appear likely to rise.

ICELANDIC BANK INVESTMENT UPDATE

3.22 £0.2m of the original £10m deposit 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.

LOBOs (Lender Option Borrower Options)

3.23 The Council has a market loan portfolio comprising a total value of £95.5m. Of this, £80.5m are LOBOs with the remaining £15m made up of fixed rate loans. As noted in the previous report, Arlingclose have advised us that some of our other lenders may consider giving up these rights. There was no further changes to the LOBO portfolio since the last update.

COMPLIANCE

3.24 Officers confirm that they have complied with its Prudential Indicators for 2017/18, which were set in February 2017 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

3.25 The Committee is asked to note that there was a minor breach of the limits defined in the Treasury Management Strategy. An extra £0.1m was accidently invested in Blackrock Money Market Fund to take the balance above £10m. The error was promptly discovered and £0.1m was withdrawn from the fund the following day. An investigation into this breach concluded that an error in entry to the Logotech Treasury Management system was the cause. Training has been provided to officers involved in the treasury management process to ensure a recurrence of this issue does not occur again.

SUMMARY

3.26 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 2017/18. 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

There are no direct legal implications.

8 BACKGROUND

Treasury Management Strategy – Report to Full Council as part of the Budget Report – February 2017.

Contact Officer

Gareth Robinson,
Head of Finance - Capital and Treasury
Finance

Conrad HALL
Chief Finance Officer

Appendix 1

Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2017/18 to 2019/20 are shown in the table below (excluding Private Finance Initiative schemes):

	31/03/2017 Draft* £m	31/03/2018 Estimate £m	31/03/2019 Estimate £m	31/03/2020 Estimate £m
CFR	582	620	750	900

*The accounts have not been signed off as of yet, therefore the Draft number remains.

Usable Reserves

Estimates of the Council's level of Usable Reserves for 2017/18 to 2019/20 are as follows:

	31/03/2017 Draft* £m	31/03/2018 Estimate £m	31/03/2019 Estimate £m	31/03/2020 Estimate £m
Usable Reserves	116	90	75	60

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 £900m for 2017/18. 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 2017/18 was set at £800m. 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 £415m.

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 2017/18	Maximum during 2017/18
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 31/08/17 £m	% Fixed Rate Borrowing as at 31/08/17	Compliance with Set Limits?
Under 12 months	40	0	29	7	Yes
12 months and within 24 months	20	0	14	3	Yes
24 months and within 5 years	20	0	65	16	Yes
5 years and within 10 years	60	0	5	1	Yes
10 years and above	100	0	301	73	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 2017/18, 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 2017/18 was set at £40m.

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 31 August, the last maturity date in the deposits portfolio was 20 August, 2018.

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 2017/18 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	31/03/2017 Draft* £m	31/03/2018 Estimate £m	31/03/2019 Estimate £m	31/03/2020 Estimate £m
HRA CFR	139	157	177	190
HRA Debt Cap (as prescribed by CLG)	199	199	199	199
Difference	60	42	22	9

*The accounts have not been signed off as of yet, therefore the Draft number remains.