

 Brent	Audit and Standards Advisory Committee 17 October 2018
	Report from the Chief Finance Officer
2018/19 Mid-Year Treasury Report	

Wards Affected:	All
Key or Non-Key Decision:	Non-key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	Three: <ul style="list-style-type: none"> • Prudential Indicators • Maturity Structure of Fixed Rate Borrowing • Investment Strategy Options
Background Papers:	N/A
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1.0 Purpose of the Report

1.1 This report updates Members on recent treasury activity.

2.0 Recommendation

2.1 The Committee is asked to note the 2018/19 mid-year Treasury report, which is to be forwarded to the Cabinet and Council.

3.0 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 recovered somewhat in Q2 following very low growth in Q1. The most recent estimate for UK GDP growth is 0.4% for Q2. This is the same as the Eurozone however US growth has been strong. Arlingclose have advised that the outlook for the UK economy remains challenging to predict following the vote to leave the European Union. Other risks include potential trade wars which will continue to cause significant volatility in financial markets.
- 3.6 Consumer Price Index (CPI) has increased since the previous update, to 2.7% in August mostly due to increases in transport fares and recreation and culture. Employment is currently at 75.5% of the working age population, marginally down on the quarter prior however the number of people in work increased through the year. Wages excluding bonuses grew by 2.9% therefore wages including inflation only showed a very slight increase.
- 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	Mar-18	Sep-18
1 year	1.7%	1.8%
5 year	2.1%	2.1%
10 year	2.4%	2.5%

- 3.8 The interest rate the Council receives on money market funds has risen since the previous report and 12 month maturities with local authorities have risen from 0.8% to 1.1%.

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 2018. The Council has applied for the Certainty Rate for the period November 2018 to October 2019.
- 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 01/04/2018 £m	Debt repaid* £m	New Borrowing £m	Balance on 30/09/2018 £m
Short Term Borrowing	21	21	0	0
Long Term Borrowing	411	2.2	0	408
TOTAL BORROWING	432	2.2	0	408
Ave Rate of Long Term Borrowing %	4.82	2.58	0	4.83*

** £25m 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 average interest rate of 2.58% compared with the rest of the debt, which is 4.97%*

- 3.11 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, including the potential to agree forward funding and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor, Arlingclose.
- 3.12 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 significantly in the short-term then this approach might need to be reviewed, however forward borrowing which is under consideration largely eliminates this risk. This is because it allows the Council to agree a sum in advance of need, at a fixed rate for delivery on a pre-determined future, thereby hedging against future interest rate exposure whilst avoiding a short term increase in costs, as interest payments do not commence until the loan starts.

- 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 £0.781m, a 26% 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 01/04/2018 £m	Investments Made £m	Investments Repaid £m	Balance on 30/09/2018 £m
Short Term Investments	140	579	594	125

- 3.15 There was a £15m downward movement in short-term investments. This is expected and mainly due to the significant capital investments being applied to new NAIL schemes, loans to I4B and investment in the HRA stock. This downward trend in investment balances is expected to continue in the coming years as the capital programme is progressed. YTD capital spend for 18-19 currently stands at £52m with the forecast for the full year £162m. This is having a significant impact on our cash available for investment and as noted in para 3.11 the use of internal balances to fund capital expenditure will not be sustainable over the medium to long term.
- 3.16 The Council has undertaken a detailed analysis of its cash flows, examining the pace at which we are reducing our cash reserves. The analysis was based on forecast capital commitments, incoming resources and seasonal variations. As reported to Cabinet in September 2018 the prediction is that the council will need to borrow towards the end of 2020, to a certain extent 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, forward borrowing and other market loans. At the same meeting Cabinet endorsed an updated borrowing strategy that included a recommendation to commence negotiations to agree a forward funding loan of up to £40m. 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 2018/19. New investments were made with the following classes of institutions:

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

A short summary of the investment products available to the council is provided in Appendix 3.

- 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 £137m during the period to 31 September 2018.
- 3.21 The UK Bank Rate increased to 0.75% from 0.50% on 02 August 2018. Following this decision short-term money market rates have increased in response however rates are very low compared to historic rates. This will lead to an increase on the return of the council's investment portfolio though this will be gradual because existing fixed rate investments will be held to maturity.

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 2018/19, which were set in February 2018 as part of the Council's Treasury Management Strategy Statement (TMSS). Details can be found in Appendix 1.

Summary

- 3.25 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 2018/19. 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.

4.0 Financial Implications

- 4.1 These are covered throughout the report.

5.0 Legal Implications

- 5.1 There are no direct legal implications.

6.0 Equality Implications

- 6.1 No direct implications.

7.0 Consultation with Ward Members and Stakeholders

- 7.1 None.

Report sign off:

Conrad Hall
Chief Finance Officer