Report for: AUDIT COMMITTEE FOR INFORMATION	
Item Number: 7	

Contains Private and Confidential Information	**YES** (Appendix 4)	Pursuant to para. (3) of Schedule 12A of the Local Government Act 1972
Title	**Treasury Management Mid–Year Update 2016/17**	
Responsible Officer	Ian O'Donnell: Executive Director of Corporate Resources. Ross Brown : Acting Director of Finance	
Author(s)	Bridget Uku, Treasury & Investments Manager, Tel: 020 8825 5981. E-mail: ukub@ealing.gov.uk	
Portfolio	Cllr Yvonne Johnson - Finance, Performance & Customer Services.	
For Consideration By	Audit Committee	
Date to be Considered	29 November 2016	
Implementation Date if Not Called In	N/A	
Affected Wards	N/A	
Area Committees	N/A	
Keywords/Index	Treasury, Borrowing, Lending, Investments.	

Purpose of Report

This report provides an update on the Council's borrowing and investment activities for the six months ending 30 September 2016. Due to timing of the Audit Committee meeting cycle, the Treasury Position as at 30th June 2016 is attached as Appendix 3 to this report.

Over the reporting period, all treasury management activities have been carried out in accordance with the approved limits. The report also provides information on the prevailing economic conditions over the reporting period.

1. Recommendations

Members are recommended to:

1.1 Note the Treasury Management activities and performance against targets for the six months to 30 September 2016.

1.2 Note the Council's investment balance of £195.932m as at 30 September 2016 of which £140.302m was invested in other Local Authorities (set out in Appendix 1).

1.3 Note the Council's position on prudential indicators (set out in Appendix2).

1.4 Note the Council's current lending list (set out in confidential Appendix 4).

2. Reason for Decision and Options Considered

2.1 This report updates on both the borrowing and investment decisions made by the Director of Finance under delegated authority in the context of the prevailing economic conditions and considers Treasury Management Performance measured against the benchmark 7 day LIBID rate.

2.2 Treasury management is defined as "the management of the council'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".

Summary

2.3 The key messages from this report are that:

- All treasury management activities were executed by authorised officers within the parameters agreed by the Council.
- All investments were made to counterparties on the Council's approved lending list and within agreed limits.
- Long-term borrowing of £40m from PWLB was raised during the period to 30 September 2016.
- The existing long-term debt increased to £503.853, there was a PWLB maturity of £7.805m in period to 30 September 2016.
- The Council earned an average investment return of 0.502% on short term lending, outperforming the rolling average 7 Day LIBID rate of 0.283%.
- The Council currently holds no investments with overseas financial institutions.
- The HRA debt is managed separately from General Fund debt.

2.4 A glossary of terms is set out at the end of this report, to make this technical report as user friendly as possible.

3. Treasury Management Strategy 2016/17

3.1 The Council's Treasury Management Strategy for 2016/17 was approved on the 23 February 2016 by Full Council. The strategy comprehensively outlined how the treasury function would operate throughout the financial year 2016/17 including the limits and criteria to be used to determine organisations in which we will investment of surplus cash and the council's policy on long-term borrowing and limits on debt. The Council complied with the strategy during the period to 30 September 2016.

Investment of Pension Fund Cash

3.2 The Pension Fund surplus cash has been invested in accordance with the Council's Treasury Management Strategy agreed by Full Council on the 23 February 2016, under the delegated authority of the Director of Finance to manage within agreed parameters. The Treasury Management Strategy is reviewed on a monthly basis at the Treasury Risk & Investment Board (TRIB), a meeting consisting of Corporate Finance officers, and chaired by the Executive Director of Corporate Resources. The Pension Fund Panel (PFP) is updated on Pension Fund investment activity and the Chair of the PFP is briefed regularly.

4. Economic Background

4.1 The following is a summary of key economic conditions prevailing during the first half of the financial year 2016/17: -

- The economy remained surprisingly robust since Brexit;
- Households and firms shrugged off referendum uncertainty;
- The labour market began to soften;
- CPI inflation started to pick up;
- The Bank of England cut interest rates and expanded their asset purchases;
- The ECB and the US Fed kept policy unchanged;

4.2 The economic recovery regained some momentum in the quarter ending 30 June 2016 2016, with real GDP growth accelerating from 0.4% in Q1 to 0.7% in Q2 – an annual rate of 2.1%. Both households and firms appeared to shrug off pre-referendum uncertainty, driving the acceleration. Growth however looks to have slowed in the quarter following the referendum although no outright recession is indicated.

4.3 The drop in the pound appears to be having a positive impact on exports, with goods volumes up by 2% on the month. Household spending suggests that consumers are coping well post-referendum with annual retail sales growth standing at a robust 6.2%.

4.4 Unemployment levels remain low, though some firms may start to put off hiring in view of the uncertainty following the Brexit vote.

4.5 There are signs that price pressures are building at the start of the production pipeline, with producer input costs rising by an annual 7.6% in August. This will feed through to higher prices in shops in time. As such, inflation is expected to break through the MPC's 2% target by mid-2017. Indeed, the Monetary Policy Committee (MPC) revised up its inflation forecasts in the August Inflation Report to show inflation remaining above the target from the latter half of 2017 onwards.

4.6 Despite this, the MPC implemented a package of policy measures to cushion the economy from the adverse effects of the Brexit vote: -

- a cut in Bank Rate from 0.50% to 0.25%
- new gilt purchases of £60bn
- corporate bond purchases of £10bn
- a new Term Funding Scheme (TFS) to provide cheap funds to banks

4.7 However, the continued resilience of post-referendum data has led to some suggestions that the August loosening package was premature and unnecessary. Nonetheless, the package is probably part of the reason why the economy has bounced back.

4.8 However, unlike the Bank of England, both the Federal Reserve and the ECB kept rates on hold during the quarter ending 30 September 2016. Nonetheless, 14 out of the 17 Federal Open Market Committee (FOMC) officials still expect at least one rate hike this year, suggesting the Fed is still on track for a hike in December. President Mario Draghi stated again that the Bank was "ready, willing and able to act" if required. In particular, he stressed that asset purchases would continue until at least March 2017.

4.9 On the fiscal policy front, new Chancellor Phillip Hammond will set out how the government will use tax and spending to bolster the UK economy at the Autumn Statement on the 23rd November.

4.10 Turning to markets, the FTSE 100 is up by around 10% since the vote to leave, the FTSE 250 with a higher exposure to the domestic market, is only up by 3%. However, the even more domestically focused FTSE local which only includes firms from which 70% of their sales are generated in the UK, is down by over 5%.

4.11 Finally, in regards to Brexit, there is still not much detail to the government's plans for the new UK-EU relationship. Indeed, the prime minister has stated that Article 50 won't be triggered until the first quarter of 2017. What's more, the chance of a "hard Brexit" deal appears to have grown following her statement that immigration controls will take precedence. Officers continue to monitor the position, but no concrete investments decisions can be taken in respect of Brexit with so many aspects of the shape of Brexit being unknown. Risk management remains a high priority when officers make investment decisions.

4.12

<u>Economic Forecast</u>

The Council's treasury advisor, Capita Asset Services, has provided the following forecast;

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bank Rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
5yr PWLB Rate	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
10yr PWLB rate	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
25yr PWLB rate	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
50yr PWLB Rate	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

5. Treasury Management Strategy Statement

Annual Investment Strategy

5.1 The Council's Annual Investment Strategy is an integral part of the approved Treasury Management Strategy 2016/17 and there are no proposed changes to that strategy. It outlines the Council's investment priorities as follows (in order of priority).

- Security of Capital
- Liquidity
- Yield

5.2 The Council aims to achieve the optimum return on investments commensurate with proper levels of security and liquidity.

5.3 The Council managed its investments in-house and invested with institutions on the Council's approved lending list (Appendix 4). Following the global financial crises and persistent uncertainties, the Council remains relatively risk averse and operates a restricted lending list and a summary of the institutions to which the Council invested with is outlined below:

1. The UK Government directly (Debt Management Office)
2. The UK Government (Treasury Bill via King & Shaxson)
3. RBS and Lloyds (because of the UK government's stake in these institutions) Lloyds limit was reduced in recognition of the Government's significantly reduced stake.
4. The Council's banker (Lloyds)
5. HSBC
6. Standard Chartered Bank (Certificate of Deposit via King & Shaxson)
7. Barclays Bank
8. Nationwide Building Society
9. Local Authorities

Overall Treasury Cash Flow Position as at 30 September 2016

The Council's temporary borrowing and lending activity (that is 364 days or less) over the period is set out below:

Description	Borrowing £m	Lending £m	Net Position £m
Outstanding 31 March 2016	9.000	(191.732)	(182.732)
Raised/ (lent) during period	202.700	(1,322.110)	(1,119.410)
Repayments during period	(181.700)	1,317.910	1,136.210
Outstanding 30 September 2016	**30.000**	**(195.932)**	**(165.932)**

5.4 Over the 6 months to 30 September 2016, the Council's cash flows were maintained through borrowing and lending activities on the wholesale money market and the net position outstanding at 30 September 2016 was temporary lending of £165.932m.

5.5 No temporary borrowing was required during the period.

5.6 Members are advised that the Council continues to place investments with a number of local authorities and these are considered to be of high credit quality and are therefore on the Council's approved list of counterparties. In the DCLG's Investment Guidance issued to Councils, Local Authority deposits are deemed to offer "high security and high liquidity". The Council had 32 investments placed across a number of councils totaling £140.302m as at 30 September 2016, these are set out in Appendix 1.

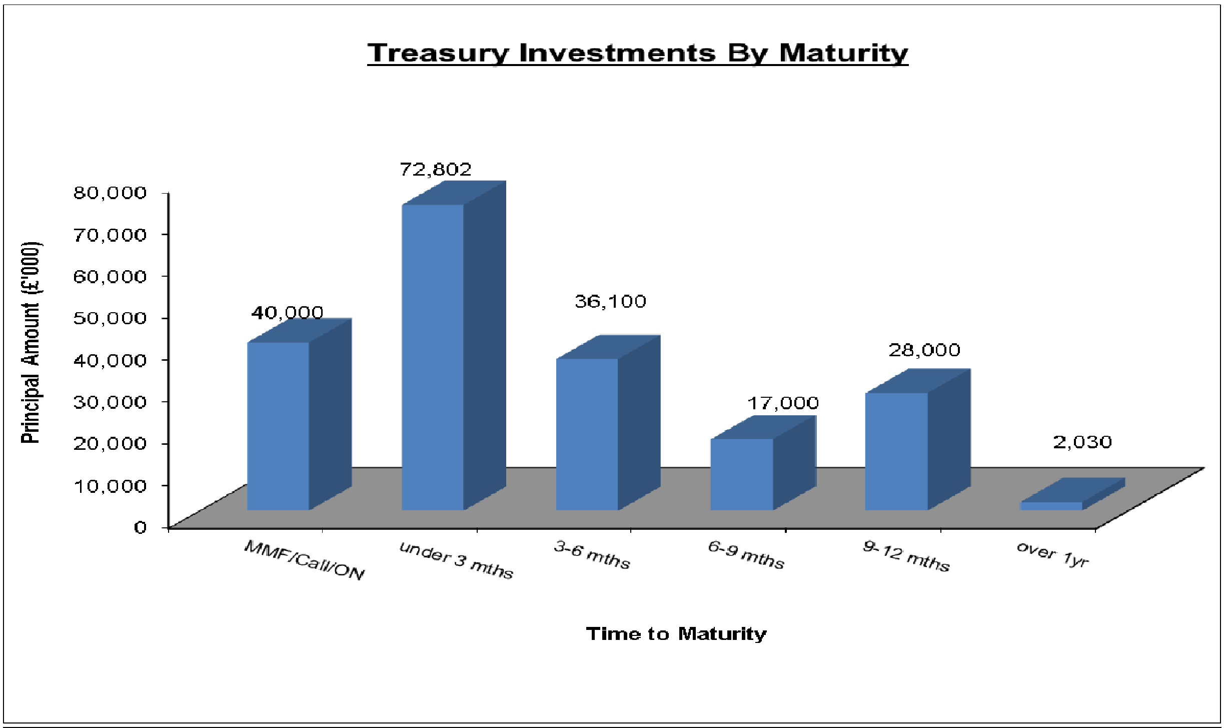
5.7 The Councils total Investments held at 30 September 2016 are outlined below

Counterparty Name	Total Investment as at 31/03/16 (£m)	Total Investment as at 30/09/16 (£m)
Local Authorities	(93.802)	(140.302)
HSBC	(30.000)	(30.000)
Lloyds Bank	(17.300)	(10.000)
Royal Bank of Scotland Group	(15.000)	-
Barclays	(20.000)	-
Nationwide Building Society	(15.000)	(15.000)
Future Ealing Ltd	(0.600)	(0.600)
Ealing Community Resource Centre	(0.030)	(0.030)
Total Investment	**(191.732)**	**(195.932)**

5.8 Investment activities during the quarter conformed to the approved strategy, and the Council did not experience any liquidity difficulty.

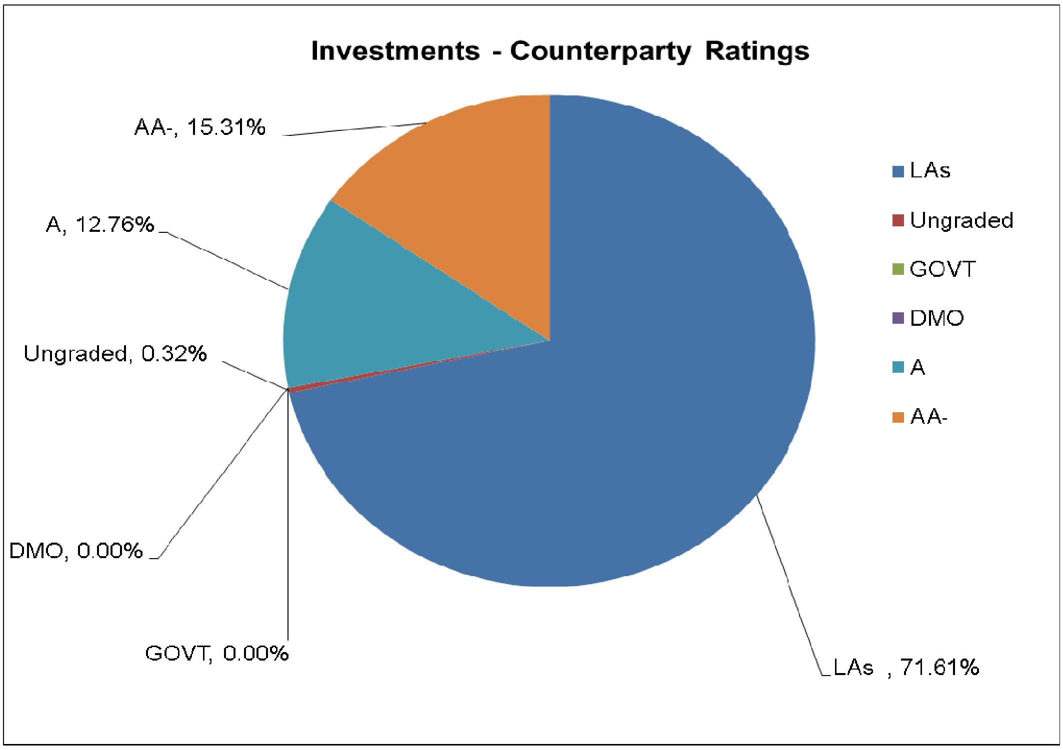
5.9

Investment Maturity Profile at 30 September 2016



- *The Council currently has two investments that have a maturity period of over one year – Cheshire West & Chester Council and Ealing Community Resource Centre*

Investments by Counterparty Rating at 30 September 2016



Ungraded: includes Future Ealing of 0.26% and Ealing Community of 0.02% AA, A – Fitch credit rating.

Performance vs Benchmark

5.10 Council investment returns outperformed the benchmark (7 day LIBID rate) during the reporting period. The table below outlines this performance.

Month	Council Performance %	Benchmark Rate (7day LIBID rate) %	Outperformance %
April 2016	0.542	0.362	0.180
May 2016	0.562	0.364	0.198
June 2016	0.540	0.361	0.179
July 2016	0.477	0.352	0.124
August 2016	0.454	0.139	0.315
September 2016	0.438	0.119	0.318
Average	0.502	0.283	0.219

5.11 The Council maintained an average balance of internally managed funds of £201.82m (gross of short term borrowing) over the six months and had an outstanding balance of £195.932m as at 30 September 2016. The internally managed funds earned an average rate of return of 0.502%, whilst the comparable performance indicator, the average 7-day LIBID rate, returned 0.283%. The Council's key investment philosophy remained the prudent approach to counterparty selection and an emphasis on security of capital and liquidity ahead of yield.

5.12 The ongoing uncertainties in financial markets have led TRIB to continue to place investments only with high quality counterparties such as the DMO and other local authorities. The outcome of this policy is a reduction in the investment income received by the Council that could otherwise be generated.

6 Long Term Borrowing Requirement and Debt

6.1 The Council's Treasury Management Strategy Report approved in February 2016 outlined the Council's long term borrowing strategy for the year.

HRA Self Financing

6.2 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

6.3 Total long term borrowing stood at £503.853m (including Mortlake Crematorium Board Loan) as at 30 September 2016. The following table shows the split between General Fund and HRA borrowing, and that overall increased by £32.470m from £471.384m at the start of the financial year.

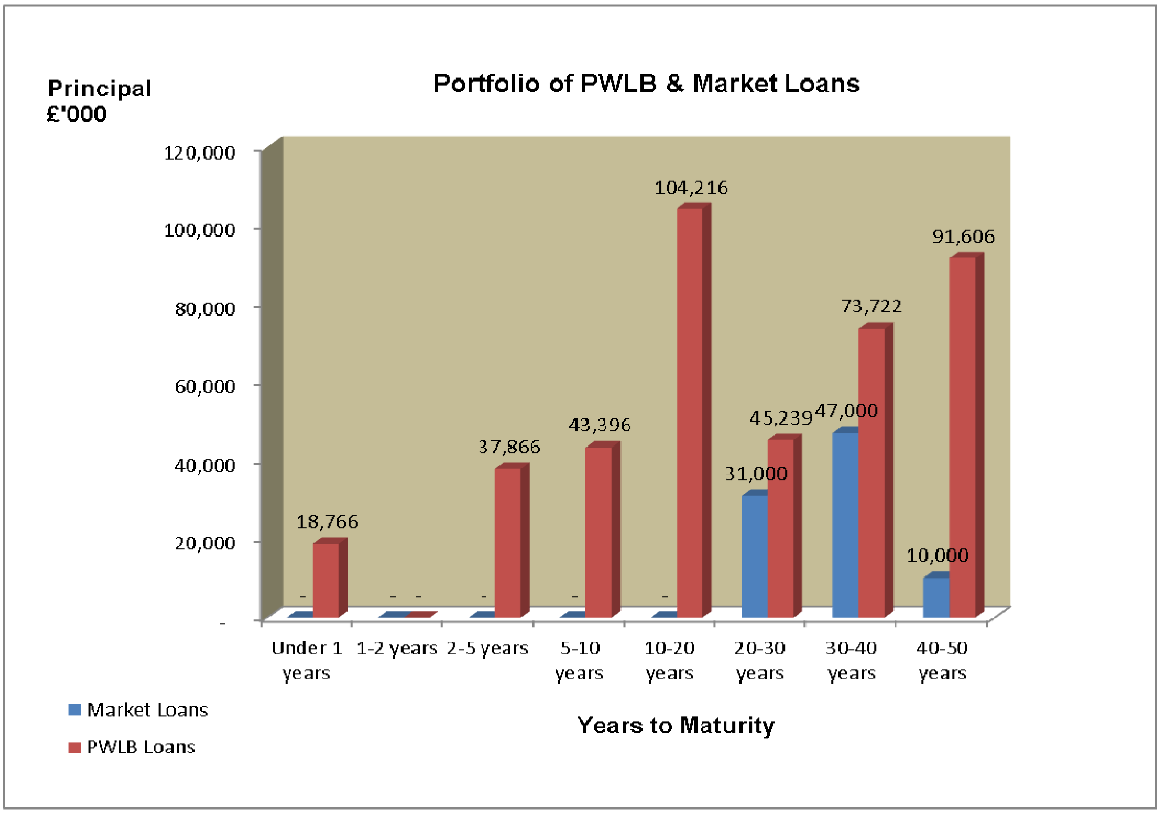
Source	Debt as at 31/03/16 £m	Loans raised £m	Loans repaid £m	Debt as at 30/09/16 £m
General Fund				
PWLB	269.642	28.189	(5.500)	292.330
Market Loans	62.016	-	-	62.016
*Mortlake Crematorium	0.768	0.275	-	1.043
Total General Fund	**332.426**	**28.464**	**(5.500)**	**355.389**
HRA				
PWLB	112.974	11.811	(2.305)	122.480
Market Loans	25.984	-	-	25.984
Total HRA	**138.958**	**11.811**	**(2.305)**	**148.464**
Total Long Term Borrowing	**471.384**	**40.275**	**(7.805)**	**503.853**
**Memo Item: PFI Obligation	130.243	-	(3.924)	126.319

Notes:

**The £0.275m 'loan raised' figure relates to the arrangement with Mortlake Crematorium where monies are passed by Mortlake Crematorium Board for investment by the Council on the Boards behalf*

***PFI schemes are shown on the balance sheet as long term creditors and are not classified under accounting rules as debt so are shown as a memo item here for completeness.*

6.4 The Council's actual borrowing at the end of the quarter of £503.853m was within the anticipated year end Capital Financing Requirement (CFR) of £693.373m. Although £40m long term borrowing was raised in the second quarter to take advantage of the low interest rate, the actual borrowing is behind the Council's CFR hence there remains an element of internal borrowing.



- *The above graph does not include the Mortlake loan of £1.042m.*

Debt Rescheduling

6.5 Movements in interest rates over time can produce dislocations, which can present opportunities for the Council to replace existing loans with new loans at lower rates. This is known as debt rescheduling. The Council can also repay existing loans early without necessarily replacing the loans. These activities will attract a discount or premium depending on the prevailing market conditions. Debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010.

6.6 No debt rescheduling opportunities have arisen during the year, as the cost of premium to repay debt outweighs savings that could be achieved from the lower PWLB borrowing rates.

PWLB Certainty Rate

6.7 The government launched a discounted borrowing rate as part of the Budget in March 2012. The PWLB Certainty Rate was introduced by the PWLB in November 2012, allowing the Council to borrow at a reduction of 0.2% on the Standard Rate.

7. Treasury Management Update Outside the Reporting Period

Money Market Funds (MMFs)

7.1. The Council's counterparty list was recently extended to include MMFs which are very liquid funds investing globally in a diversified range of underlying instruments with highly rated counterparties. All the funds chosen are AAA rated with constant Net Asset Values (NAV's) strong sponsors and should provide a safe home for short term cash, with ready liquidity and relatively better returns given the transient nature of the authority's cash flows.

7.2. This does mean that the authority will now have exposure to foreign institutions, but given the uncertainty surrounding Brexit; it is prudent for the authority to diversify away from the current UK focused stance.

8. Treasury Management Governance and Scrutiny

8.1 The Council continues to review and ensure that it embraces best practice in the risk management, control, monitoring and reporting of its treasury management processes.

8.2 In addition to the regular quarterly reports to audit committee, regular monitoring of Treasury Management activities is carried out by senior management, the portfolio holder for Finance and the Treasury Risk and Investment Board (TRIB) which is chaired by the Executive Director of Corporate Resources.

9 Financial implications

9.1 The Treasury Management outturn position has continued the trend of recent years, with a lower Finance and Interest charges and reduced spending mainly attributable to deferred borrowing and some slippage on the capital programme. The current market conditions support this strategy however the borrowing position is kept under constant review and should conditions start to change then new borrowing will be considered. The current forecast for 2016/17 shows spending to be on budget.

10 Prudential Indicators

10.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

10.2 The benefit of the indicators will be derived from monitoring them over time rather than from the absolute value of each. The indicators are not intended to be used as comparators between councils. The mid-year prudential indicators estimate is attached as Appendix 2.

11 Legal

11.1 The lending of surplus funds and any borrowing must comply with the Local Government Act 2003 as amended by regulations from time to time by the Government. Local authorities by virtue of section 15 (1) (a) of the 2003 Act must have regard to any guidance on investments issued by the Secretary of State, the latest such guidance was issued in April 2010. Further, local authorities must have regard to other guidance specified by the Secretary of State under section 15 (1) (b) of the 2003 Act. Section 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 specifically mentions that local authorities shall also have regard to CIPFA's Code of Practice on Treasury Management in the Public Services, the latest version of which was published in 2011.

11.2 To comply with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 requires full Council to approve an Annual Statement of Minimum Revenue Provision.

12 Value For Money

12.1 Assessment of value for money is achieved through:

- Monitoring against benchmarks
- Operating within budget

12.2 For example, internally managed investment returns exceeded the LIBID benchmark on the 30 September 2016 and PWLB borrowing was monitored throughout the year, the budgeted rate was 5.00%. In addition, the treasury function operated within budget over the reporting period.

13 Risk Management

13.1 There is no treasury management activity without risk. Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. When placing investments with counterparties, risk management and security of capital always remain the priority over returns.

13.2 The adoption of the CIPFA Code for Treasury Management in Public Services, the use of a Lending List and receiving advice from Capita Asset Services mitigate some of the risk associated with optimising performance returns. Security of capital remains the priority in the Council's investment with counterparties. The Treasury Team continue to be alert to concerns about the current Eurozone debt situation (e.g. Portugal, Ireland, Greece, Spain and Italy) and this is reflected in the Council's Lending List.

14 Community Safety

14.1 None

15 Links to Strategic Objectives

15.1 Proper and effective management of the Treasury Management function is an essential element of the financial administration process within the Council. Income generated from this source makes a significant contribution to the resources available to fund the Councils strategic objectives.

16 Equalities and Community Cohesion

16.1 None

17 Staffing /Workforce and Accommodation Implications

17.1 None

18 Any Other Implications

18.1 None

19 Consultation

19.1 Capita Asset Services provide the Council with advice on treasury management.

20 Timetable for implementation

20.1 Not applicable

21 Appendices

21.1 Appendix 1 - Investment in Local Authorities
Appendix 2 - Prudential Indicators Mid-Year Outturn 201617
Appendix 3 –TM Position Update – 30 June 2016
Appendix 4 – LB Ealing Lending List – Private & Confidential

22 BACKGROUND INFORMATION

22.1 Lending and borrowing investments files kept on the 5th floor Perceval House.

Consultation

Name of consultee	Department	Date sent to consultee	Date response received	Comments appear in report para:
Ian O'Donnell	Executive Director of Corporate Resources	07-11-16		
Ross Brown	Acting Director of Finance	07-11-16	07-11-16	
Maria Campagna	Strategic Finance Partner-Corporate	07-11-16	11-11-16	
Paddy Quill	Legal	07-11-16	09-11-16	
Helen Harris	Director of Legal & Democratic Services	07-11-16		
Cllr Yvonne Johnson	Portfolio Holder for Finance, Performance & Customer Services	07-11-16		
Cllr Tim Murtagh	Chair, Audit Committee	11-11-16		

Report History

Decision type: For Action/Information	**Urgency item? No**

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
	01-11-16	21-11-16	14-11-16

Report no.:	Report author and contact for queries:
	Bridget Uku, Treasury & Investments Manager, ext 5981

Glossary of terms used in the report

CFR - Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.

Counterparties - Organisations the Council lends money to e.g. Banks; Local Authorities and MMF.

CPI & RPI - Consumer Prices Index & Retail Prices Index
The main inflation rate used in the UK is the CPI. The Chancellor of the Exchequer bases the UK inflation target on the CPI. The CPI inflation target is set at 2%. The CPI differs from the RPI in that CPI excludes housing costs. Also used is RPIX, which is a variation of RPI, one that removes mortgage interest payments.

Credit Default Swap (CDS) - A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.

Credit watch - Variety of special programs offered by credit rating agencies and financial institutions to monitor organisation/individual's (e.g. bank) credit report for any credit related changes. A credit watch allows the organisation/individuals to act on any red flags before they can have a detrimental effect on credit score/history.

DMO - Bank of England's Debt Management Office.

Escrow Account – A money account held by an independent third party and disbursed upon fulfillment of certain contractual conditions.

Gilts - Bonds issued by the UK government. The holder is paid a fixed cash amount (coupon) every six months until maturity, at which point the final coupon is paid along with the principal.

IMF - The International Monetary Fund is an intergovernmental organisation which states its aims as to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

Impaired investment - An investment that has had a reduction in value to reflect changes that could impact significantly on the benefits expected from it.

LIBID - The London Interbank Bid Rate – it is the interest rate at which major banks in London are willing to borrow (bid for) funds from each other.

Market Loans - Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.

MMF - Money Market Fund – a 'pool' of different types of investments managed by a fund manager, that invests in lightly liquid short term financial instruments with high credit rating.

MPC - Monetary Policy Committee- Committee designated by the Bank of England, whose main role is to regulate interest rates.

MRP - Minimum Revenue Provision – this is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.

Premium - Cost of early repayment of loan to PWLB to compensate for any losses that they may incur.

Prudential Indicators - Set of rules providing local authorities borrowing for funding capital projects under a professional code of practice developed by CIPFA and providing measures of affordability and prudence reflecting the Council's Capital Expenditure, Debt and Treasury Management.

PWLB - Public Works Loan Board, a statutory body whose function is to lend money to Local Authorities (LAs) and other prescribed bodies. The PWLB normally are the cheapest source of long term borrowing for LAs.

QE - Quantitative Easing. Usually, central banks try to raise the amount of lending and activity in the economy indirectly, by cutting interest rates. Lower interest rates encourage people to spend, not save. But when short term interest rates can go no lower, a central bank can buy government bonds (including long-term bonds) or other financial assets (e.g. corporate bonds) in an effort to increase money supply and stimulate the economy. This is quantitative easing.

Treasury Bill – Short term debt instruments issued by the Government. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.