



**Report for: AUDIT COMMITTEE**

FOR INFORMATION

**Item Number:**

<b>Contains Private and Confidential Information</b>	<b>YES</b> (Appendix 3)	Pursuant to para. (3) of Schedule 12A of the Local Government Act 1972
<b>Title</b>	<b>Treasury Management Mid-Year Update 2015/16</b>	
<b>Responsible Officer</b>	Ian O'Donnell: Executive Director of Corporate Resources. Maria G. Christofi : Director of Finance	
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<b>Portfolio</b>	Cllr Yvonne Johnson - Finance, Performance & Customer Services.	
<b>For Consideration By</b>	Audit Committee	
<b>Date to be Considered</b>	20 January 2016	
<b>Implementation Date if Not Called In</b>	N/A	
<b>Affected Wards</b>	N/A	
<b>Area Committees</b>	N/A	
<b>Keywords/Index</b>	Treasury, Borrowing, Lending, Investments.	
<b>Purpose of Report</b> This report provides an update on the Council's borrowing and investment activities for the six months ending 30 September 2015. 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 2015.
- 1.2 Note the Council's investment balance of £194.225m as at 30 September 2015 of which £50.802m 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 3).

## **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.
- There was no long-term borrowing raised during the period to 30 September 2015.
- The existing long-term debt reduced to £471.584m following a PWLB maturity of £12.734m in period to 30<sup>th</sup> September 2015.
- The Council earned an average investment return of 0.555% on short term lending, outperforming the rolling average 7 Day LIBID rate of 0.387%.
- 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 2015/16**

3.1 The Council's Treasury Management Strategy for 2015/16 was approved on the 24 February 2015 by Full Council. The strategy comprehensively outlined how the treasury function would operate throughout the financial year 2015/16 including the limits and criteria for organisations to be used for the 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 2015.

## 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 24 February 2015, 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 2015/16: -

- UK GDP growth continues to outstrip other G7 countries, though headwinds point to a possible slow down.
- Strong consumer demand is expected to drive UK growth
- Inflation expectations remain subdued.
- Expectations of US Federal Reserve rate rise did not materialise due to the Fed's perceived risk of how external imbalances might impact the US economy.

- 4.2 UK GDP growth rates in 2014 were the strongest growth rates of any G7 country; However the economy may face difficulties brought on by the rise in sterling impacting exporters, weak growth of the UK's main trading partners and the negative impact of the Government's continuing austerity programme all be it that this was eased in the May budget.

- 4.3 The August Bank of England Inflation Report forecast was notably subdued in respect of inflation which was forecast to barely get back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon re-enter the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.
- 4.6 USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015. While there had been confident expectations during the summer that the Fed. could start increasing rates at its meeting on 17 September, or if not by the end of 2015, the recent downbeat news about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were disappointingly weak and confirmed concerns that US growth is likely to weaken. This has pushed back expectations of a first rate increase from 2015 into 2016.

- 4.4 EZ. In the Eurozone, the ECB announced its QE programme in January 2015 unleashing a €1.1 trillion programme of quantitative easing to buy up high credit quality

government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This already appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

### Economic Forecast

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

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
<b>Bank Rate</b>	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%
<b>5yr PWLB rate</b>	2.40%	2.50%	2.60%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
<b>10yr PWLB rate</b>	3.00%	3.20%	3.30%	3.40%	3.50%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
<b>25yr PWLB rate</b>	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
<b>50yr PWLB rate</b>	3.60%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%

## **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 2015/16 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 3). 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 2015

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 2015	-	(231.642)	(231.642)
Raised/ (lent) during period	-	(4,788.175)	(4,788.175)
Repayments during period	-	4,825.592	4,825.592
Outstanding 30 September 2015	-	<b>(194.225)</b>	<b>(194.225)</b>

- 5.4 Over the 6 months to 30 September 2015, 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 2015 was temporary lending of £194.225m.
- 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 8 investments placed across a number of councils totaling £50.802m as at 30 September 2015, these are set out in Appendix 1.

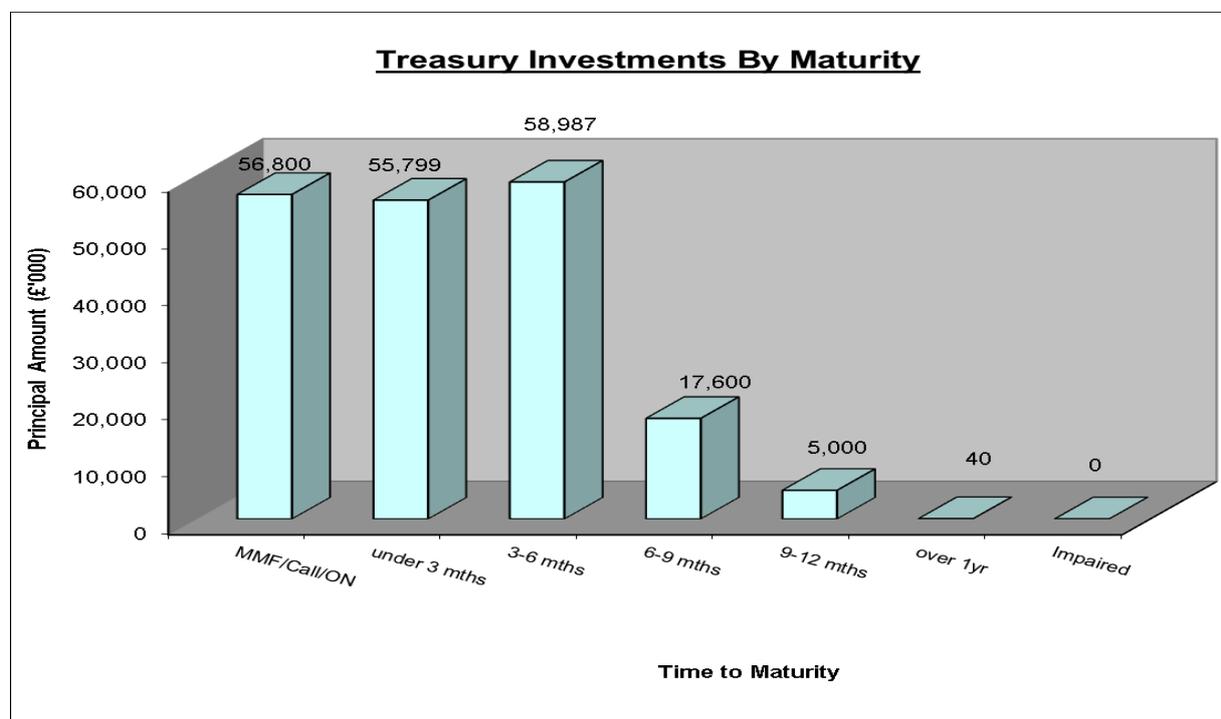
5.7 The Councils total Investments held at 30 September 2015 are outlined below

Counterparty Name	Total Investment as at 31/03/15 (£m)	Total Investment as at 30/09/15 (£m)
Local Authorities	(87.502)	(56.802)
Debt Management Office	(13.500)	-
HSBC	(30.000)	(30.000)
Standard Chartered Bank	-	(15.000)
Lloyds TSB Bank Call Account	(30.000)	(26.800)
Royal Bank of Scotland	(30.000)	(15.000)
Barclays	(20.000)	(20.000)
Treasury Bills	-	(14.983)
Nationwide Building Society	(20.000)	(15.000)
Future Ealing Ltd	(0.600)	(0.600)
Ealing Community Resource Centre	(0.040)	(0.040)
<b>Total Investment</b>	<b>(231.642)</b>	<b>(194.225)</b>

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

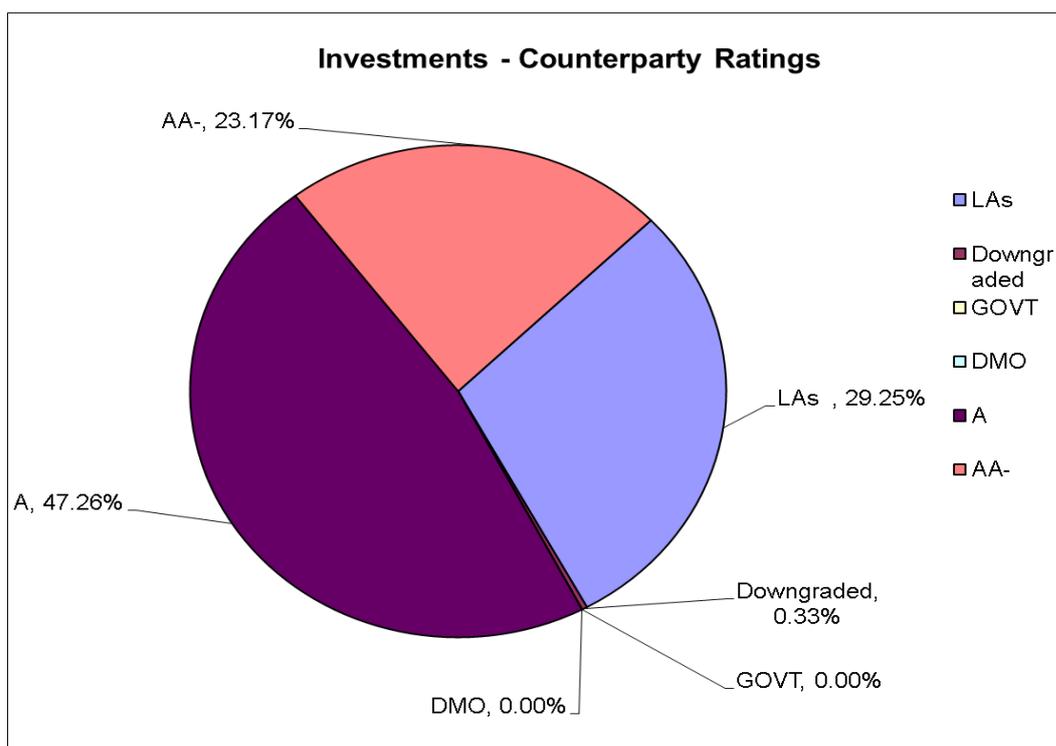
5.9

Investment Maturity Profile at 30 September 2015



- The Council currently has two investments that have a maturity period of over one year – Future Ealing and Ealing Community Resource Centre

## Investments by Counterparty Rating at 30 September 2015



*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 2015	0.517	0.361	0.156
May 2015	0.574	0.362	0.212
June 2015	0.581	0.489	0.074
July 2015	0.558	0.352	0.196
August 2015	0.563	0.362	0.201
September 2015	0.531	0.362	0.169
<b>Average</b>	<b>0.555</b>	<b>0.387</b>	<b>0.168</b>

5.11 The Council maintained an average balance of internally managed funds of £237.310m over the six months and had an outstanding balance of £194.225m as at 30 September 2015. The internally managed funds earned an average rate of return of 0.555%, whilst the comparable performance indicator, the average 7-day LIBID rate, returned 0.387%. 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 2015 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 £471.584m (including Mortlake Crematorium Board Loan) as at 30 September 2015. The following table shows the split between General Fund and HRA borrowing, and that overall debt fell by £12.734m from £484.128m at the start of the financial year.

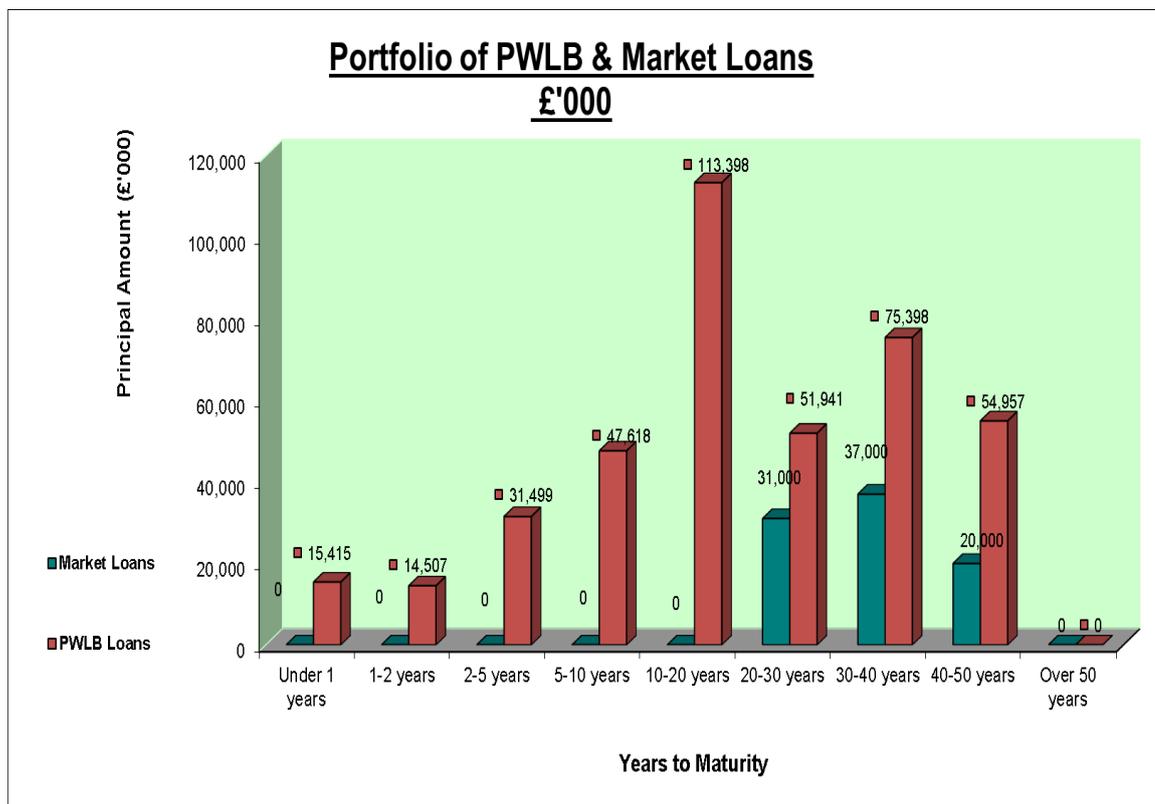
Source	Debt as at 31/03/15 £m	Loans raised £m	Loans repaid £m	Debt as at 30/09/15 £m
<b>General Fund</b>				
PWLB	278.616	-	(8.974)	269.642
Market Loans	62.016	-	-	62.016
*Mortlake Crematorium	0.778	0.190	-	0.968
<b>Total General Fund</b>	<b>341.410</b>	<b>0.190</b>	<b>(8.974)</b>	<b>332.626</b>
<b>HRA</b>				
PWLB	116.734	-	(3.760)	112.974
Market Loans	25.984	-	-	25.984
<b>Total HRA</b>	<b>142.718</b>	<b>-</b>	<b>(3.760)</b>	<b>138.958</b>
<b>Total Long Term Borrowing</b>	<b>484.128</b>	<b>0.190</b>	<b>(12.734)</b>	<b>471.584</b>
**Memo Item:				
PFI Obligation	132.860	-	(2.617)	130.243

#### Notes:

\*The £0.19m '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 Board's 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 £471.584m was within the anticipated year end Capital Financing Requirement (CFR) of £637.064m. No long term borrowing was raised in the second quarter in view of the level of investments held which allowed the Council to internally borrow; hence actual borrowing was behind the Council's CFR.



- The above graph does not include the Mortlake loan of £0.968m.

### 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.

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.

6.8 Although there has been no need to borrow in the first quarter, the Council retains its eligibility to borrow at the discounted certainty rate.

## **7. Treasury Management Update Outside the Reporting Period**

7.1 There are no key post quarter end items to update the Council on.

## **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 2015/16 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 2015 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 Council's 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 2015/16  
Appendix 3 – 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	07-01-16		
Maria G Christofi	Director of Finance	07-01-16	11-01-16	
Maria Campagna	Strategic Finance Partner-Corporate	07-01-16	08-01-16	
Paddy Quill	Legal	07-01-16	11-01-16	
Cllr Yvonne Johnson	Portfolio Holder for Finance, Performance & Customer Services	07-01-16		

### Report History

<b>Decision type: For Action/Information</b>	<b>Urgency item? No</b>
Authorised by Cabinet member:	Date report drafted: 18-12-15
Report deadline:	Date report sent: 12-01-16
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.