Report for: AUDIT COMMITTEE FOR INFORMATION
Item Number: 2

Contains Private and Confidential Information	**YES** (Appendix 2)	Pursuant to para. (3) of Schedule 12A of the Local Government Act 1972
Title	**Treasury Management Quarter 1 Update 2017/18**	
Responsible Officer	Ian O'Donnell: Executive Director of Corporate Resources. Ross Brown : Director of Finance (Deputy S151 Officer)	
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Portfolio	Cllr Yvonne Johnson - Finance, Performance & Customer Services.	
For Consideration By	Audit Committee	
Date to be Considered	27 July 2017	
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 quarter ending 30 June 2017.

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 period to 30 June 2017.

1.2 Note the Council's investment balance of £127.570m as at 30 June 2017 of which £55.000m was invested in other Local Authorities (set out in Appendix 1).

1.3 Note the Council's current lending list (set out in confidential Appendix 2).

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".

<u>Summary</u>

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.
- No long-term borrowing was raised during the period to 30 June 2017.
- The existing long-term debt decreased to £485.538m, and PWLB maturity of debt amounted to £11.393m in period to 30 June 2017.
- The Council earned an average investment return of 0.327% on short term lending, outperforming the rolling average 7 Day LIBID rate of 0.112%.
- The Council currently holds no direct investments with overseas financial institutions, though these are held indirectly through our Money Market Fund (MMF) exposure.
- 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 2017/18

3.1 The Council's Treasury Management Strategy for 2017/18 was approved on the 21 February 2017 by Full Council. The strategy comprehensively outlined how the treasury function would operate throughout the financial year 2017/18 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 June 2017.

<u>Investment of Pension Fund Cash</u>

3.2 The Pension Fund surplus cash is transferred on a monthly basis to the custodian account. Where this is held internally has been and will continue to be invested in accordance with the Council's Treasury Management Strategy agreed by Full Council on the 21 February 2017, 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 before during the quarter ending 30 June 2017 and forecast the financial year 2017/18: -

- The UK elections took place on the 8th June which resulted in a hung parliament.
- UK GDP growth rate has remained fairly stable with 1.9% growth forecast for 2017
- Inflationary pressures are expected to persist due the fall in the pound
- Wages pressures remain under subdued
- Base rates have remained at emergency rates
- Economic performance had been good in Europe, but headwinds such as election risks, Brexit and Greek debt crisis remain in the background.
- The US has not managed to deliver the Fiscal stimulus that is expected
- Chinese growth has been good, while Japan continues to struggle to get inflation above 0%

4.2 The UK GDP annual growth rates in each calendar year 2013 – 2016 of 1.9%, 3.1%, 2.2% and 1.8%, have all been the top rate, or near top rate, of any of the G7 countries in every year. UK economic performance has remained fairly robust in spite of Brexit and in the ECBs February and May 2017 Inflation Reports, the Bank upgraded its forecasts for growth (May Report - 2017 1.9%, 2018 and 2019 1.9%).

4.3 However over these years, it also expects inflation to accelerate towards nearly 3% as increases due to the fall in the value of sterling, though inflation is expected to fall back to 2.2% in 2019. Provided those cost pressures do not feed through into significantly higher domestically generated inflation within the UK, the MPC is expected to 'look though' this one off blip upwards in inflation. Wage inflation, which is a key driver of domestically generated price pressures, is currently subdued. There is, a potential risk that the MPC might put interest rate up given the recent trend with a rise in the number of members voting for a rate rise.

4.4 GDP growth in the US has been highly volatile in 2016 but overall mediocre, at an average of 1.6% for the year. Quarter 1 in 2017 has also been mediocre at 1.4% but current indications are that growth could rebound strongly in quarter 2. The disappointment so far has been the lack of progress on delivery of the fiscal stimulus package. The Fed has started to slowly increase rates now that the economy is at or around “full employment” and inflationary pressures have been building to exceed its 2% target. It has, therefore, raised rates four times, with the last three following quickly on one another in December 2016 and March and June 2017. One or two more increases are expected in 2017 and possibly four in 2018.

4.5 Growth in the EU improved in 2016, to 1.7%, after the ECB cut rates into negative territory and embarked on massive quantitative easing during the year. The ECB is now forecasting growth of 1.9% in 2017, 1.8% in 2018 and 1.7% in 2019. It has committed to continuing major monthly quantitative easing purchases of debt instruments in order to stimulate growth and to get inflation up to its 2% target.

4.6 There are major concerns about various stresses within the EU. The national election in Germany on 22 October and possibly more problematic is the general election in Austria on 15 October where a major front runner is the Freedom Party which is strongly anti-immigration and anti EU. There is also a risk of a snap general election in Italy before the final end possible date of 20 May 2018.

4.7 The Greek debt issue and the flow of migrants via Turkey had not completely disappeared and the Brexit negotiations with the UK will be difficult.

4.8 China is expected to continue with reasonably strong growth, (by Chinese standards), of 6.5% in 2017. However, medium term risks are increasing. Japan has only achieved 1% growth in 2016 and is struggling to get inflation to move from around 0%, despite massive fiscal stimulus and monetary policy action by the Bank of Japan.

<u>Economic Forecast</u>

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

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

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 2017/18 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 2). 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 in which the Council could invest in are 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

10. AAA rated Money Market Funds

Overall Treasury Cash Flow Position as at 30 June 2017

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 2017	**22.000**	**(152.920)**	**(130.920)**
Raised/ (lent) during period	67.000	(330.080)	(263.080)
Repayments during period	(69.000)	355.430	286.430
Outstanding 30 June 2017	**20.000**	**(127.570)**	**(107.570)**

5.4 Over the period to 30 June 2017, the Council's cash flows were maintained through borrowing and lending activities on the wholesale money market and the net position outstanding at 30 June 2017 was temporary lending of £107.570m.

5.5 Temporary borrowing of £67.000m was raised during the period to cover short-term cash flow requirements with the sum of £20.000m temporary borrowing outstanding at 30 June 2017.

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 13 investments placed across a number of councils totaling £ 55.000m as at 30 June 2017, these are set out in Appendix 1.

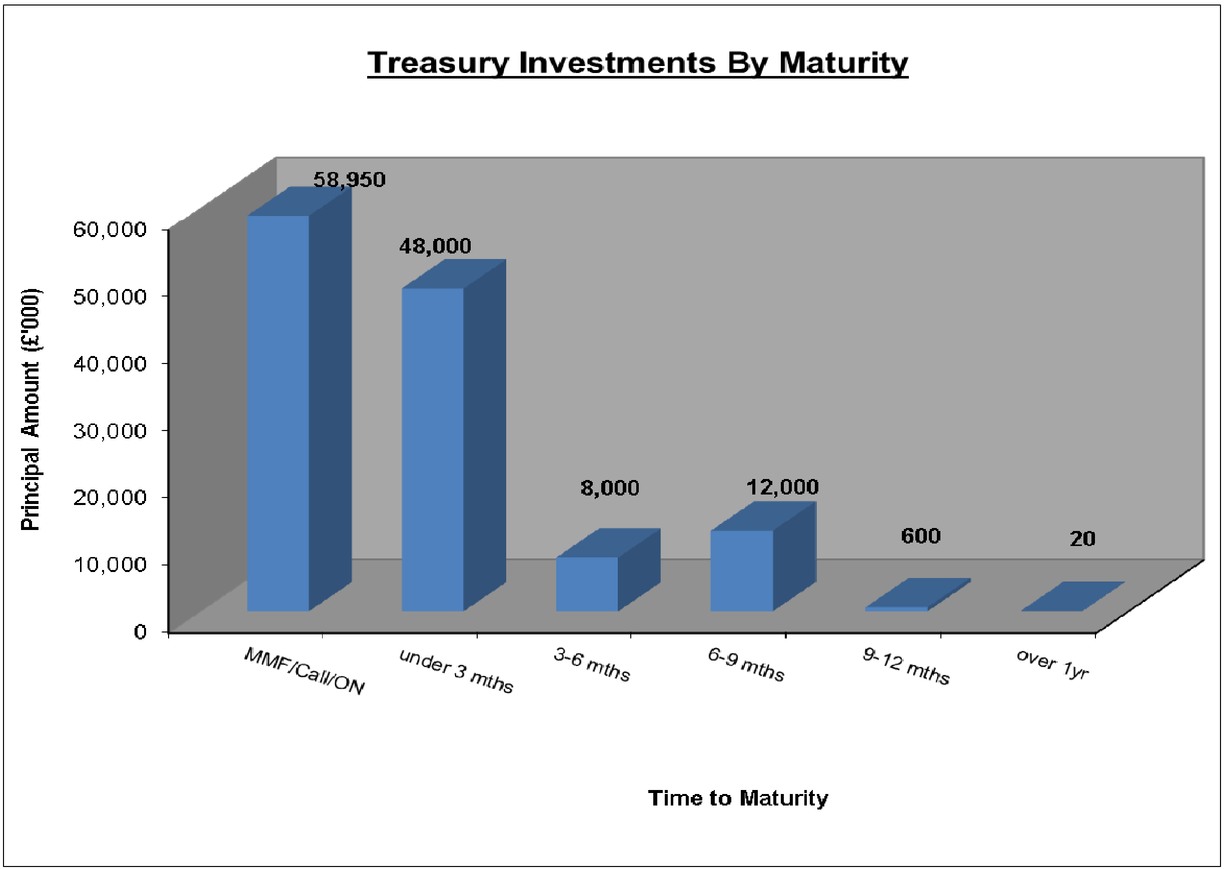
5.7 The Councils total Investments held at 30 June 2017 are outlined below

Counterparty Name	Total Investment as at 31/03/17 (£m)	Total Investment as at 30/06/17 (£m)

Local Authorities	(82.000)	(55.000)
HSBC	(30.000)	(30.000)
Lloyds Bank	(19.600)	-
Royal Bank of Scotland Group	-	-
Barclays	(3.000)	(3.000)
Nationwide Building Society	(15.000)	(10.000)
Debt Management Office	(2.700)	-
Money Market Funds	-	(28.950)
Future Ealing Ltd	(0.600)	(0.600)
Ealing Community Resource Centre	(0.020)	(0.020)
Total Investment	**(152.920)**	**(127.570)**

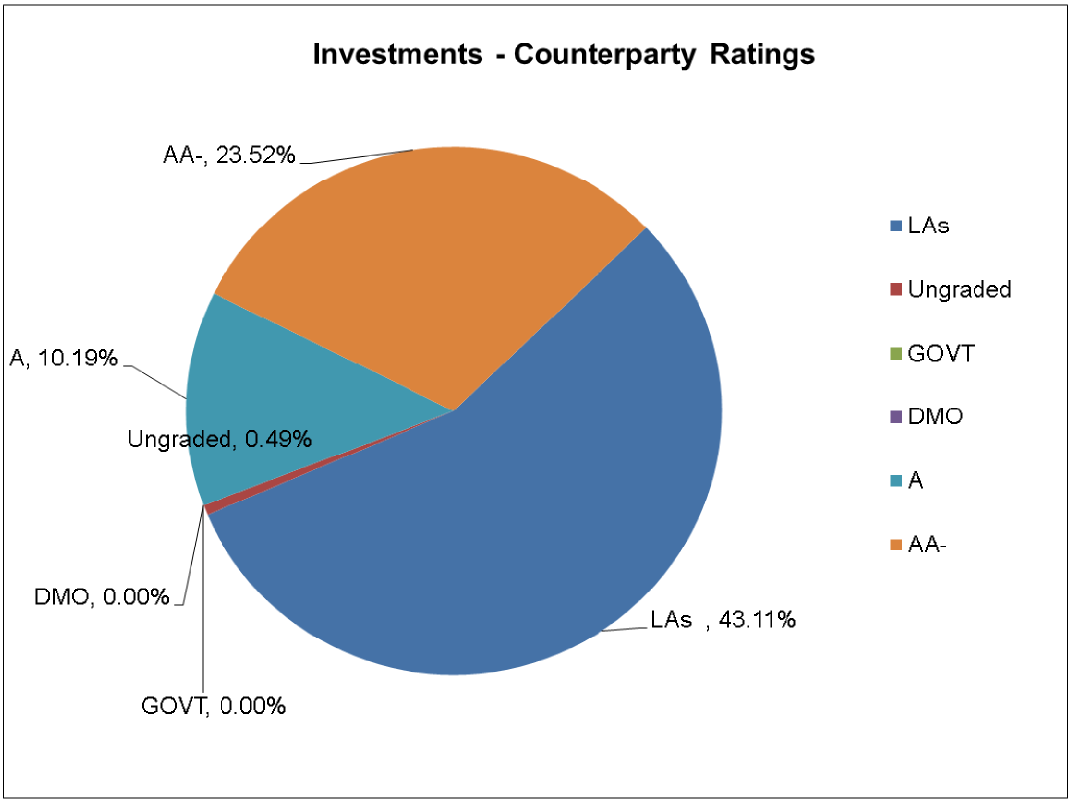
5.8 Investment activities during the quarter conformed to the approved strategy, and the Council did not experience any liquidity difficulty.

Investment Maturity Profile at 30 June 2017



- *The Council currently have one investment that have a maturity period of over one year – Ealing Community Resource Centre*

Investments by Counterparty Rating at 30 June 2017



Ungraded: includes Future Ealing of 0.47% and Ealing Community of 0.02%
AA, A – Fitch credit rating.

Performance vs Benchmark

5.9 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 2017	0.368	0.112	0.256
May 2017	0.325	0.112	0.213
June 2017	0.287	0.112	0.175
Average	0.327	0.112	0.215

5.10 The Council maintained an average balance of internally managed funds of £154.0m (gross of short term borrowing) over the nine months and had an outstanding balance of £127.570m as at 30 June 2017. The internally managed funds earned an average rate of return of 0.327%, whilst the comparable performance indicator, the average 7-day LIBID rate, returned 0.112%. 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.

5.11 As reported before the Council's Counterparty list now includes MMF's which are 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.

5.12 This does mean that the authority now has indirect exposure to foreign institutions, but officers feel it is prudent for the authority to diversify away from the current UK focused stance. As at 30 June 2017, the balance of investments outstanding across three MMFs was £28.950m.

6 Long Term Borrowing Requirement and Debt

6.1 The Council's Treasury Management Strategy Report approved in February 2017 outlined the Council's long term borrowing strategy for the year.

HRA Self Financing

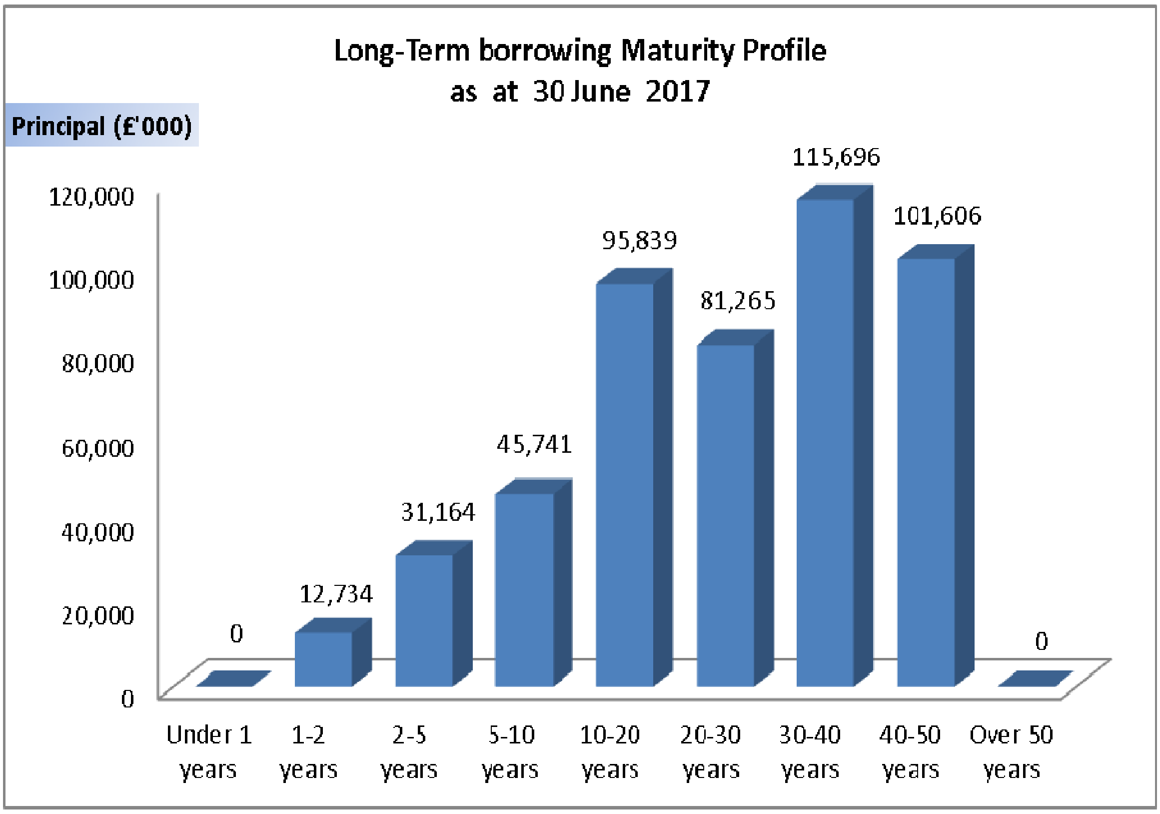
6.2 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

6.3 Total long term borrowing stood at £485.538m (including Mortlake Crematorium Board Loan) as at 30 June 2017. The following table shows the split between General Fund and HRA borrowing, and the overall decrease by £11.393m over the quarter ending 30 June 2017.

Source	Debt as at 31/03/17 £m	Loans raised £m	Loans repaid £m	Debt as at 30/06/17 £m
General Fund				
PWLB	298.945	-	(8.029)	290.916
Market Loans	62.016	-	-	62.016
*Mortlake Crematorium	1.368	0.125	-	1.493
Total General Fund	**362.330**	**0.125**	**(8.029)**	**354.425**
HRA				
PWLB	108.493		(3.364)	105.129
Market Loans	25.983	-	-	25.984
Total HRA	**134.476**	**-**	**(3.364)**	**131.113**
Total Long Term Borrowing	**496.806**	**0.125**	**(11.393)**	**485.538**
**Memo Item: Other Long Term Liabilities (OLTL)	125.319	-	-	125.319

<u>*Notes:*</u>
**The £0.125m '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*
***OLTL: 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 £485.538m was within the anticipated year end Capital Financing Requirement (CFR) including other long term liabilities (OLTL) of £800.824m. No long term borrowing was raised in the first quarter, 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 £1.493m.*

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. The Council had applied for and qualified to borrow at the preferential certainty rate.

7. Treasury Management Update Outside the Reporting Period

7.1. No significant activities or market events have occurred outside of the reporting period.

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. Prudential indicators update will be provided at the next update which will be the outturn report.

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 June 2017 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 - 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	18-07-17	18-07-17	
Ross Brown	Director of Finance (Deputy s151 Officer)	13-07-17	17-07-17	
Maria Campagna	Head of Corporate Finance	13-07-17	17-07-17	
Paddy Quill	Legal	13-07-17	17-07-17	
Cllr Yvonne Johnson	Portfolio Holder for Finance, Performance & Customer Services	17-07-17		
Cllr Tim Murtagh	Chair, Audit Committee	17-07-17		

Report History

Decision type: For Action/Information	Urgency item? No

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
	12-07-17	18-07-17	18-07-17

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.