Report for: AUDIT COMMITTEE FOR INFORMATION
Item Number: 6

Contains Private and Confidential Information	**YES** (Appendix 3)	Pursuant to para. (3) of Schedule 12A of the Local Government Act 1972
Title	**Treasury Management Mid-Year Update 2018/19**	
Responsible Officer	Ian O'Donnell: Executive Director of Corporate Resources. Ross Brown: Director of Finance (Deputy S151 Officer)	
Author(s)	Bridget Uku, Group Manager Treasury & Investments Tel: 020 8825 5981. E-mail: ukub@ealing.gov.uk Nina Bharj, Treasury & Investments Accountant Tel: 020 8825 6715. Email: bharj@ealing.gov.uk	
Portfolio	Cllr. Bassam Mahfouz – Finance & Leisure	
For Consideration By	Audit Committee	
Date to be Considered	28 November 2018	
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 to 30 September 2018.

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 September 2018.

1.2 Note the Council's investment balance of £131.410m as at 30 September 2018 of which £81.000m was invested in other Local Authorities (*Appendix 1*).

1.3 Note the Council's counterparty investment list (*Appendix 3 - Confidential*).

2. Reason for Decision and Options Considered

2.1 This report updates on both the investment and borrowing 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 Counterparty Investment list and within approved limits.
- Long-term borrowing of £15m from PWLB was raised during the reporting period to 30 September 2018.
- The existing long term debt to fund capital expenditure has increased to £546.138m due to an increased PWLB borrowing and the amounts held on behalf of the Mortlake Crematorium Board.
- The council earned an average investment return of 0.865% on short term investments, outperforming the rolling average 7 Day LIBID rate of 0.312%.
- The council currently holds no direct investments with overseas financial institutions, though these are held indirectly through the council's Money Market Funds (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 2018/19

3.1 The Council's Treasury Management Strategy for 2018/19 was approved on 20 February 2018 by Full Council. The strategy comprehensively outlined how the treasury function would operate throughout the financial year 2018/19 including the limits and criteria to be used to determine which organisations the Council would invest its surplus cash with, 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 2018.

Investment of Pension Fund Cash

3.2 The Pension Fund's surplus cash is invested in accordance with the Council's Treasury Management strategy agreed by Full Council in February 2018, which is delegated to the Director of Finance to manage on a day to day basis within set parameters. The cash is now held at the fund's custodian bank account from where it is swept nightly into a money market fund operated by Goldman Sachs.

3.3 The Treasury Management Strategy is reviewed on a monthly basis at the Treasury Risk & Investment Board (TRIB), a meeting consisting of Corporate Finance Officers including the Director of Finance, the Treasury & Investments Manager, and chaired by the Executive Director of Corporate Resources. The Pension Fund Panel (PFP) is updated on Pension Fund investment activities 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 quarter of the financial year 2018/19:

- UK growth in the first half of 2018/19 has seen a modest performance, but sufficiently robust for the Monetary Policy Committee (MPC) to increase the bank rate from 0.5% to 0.75% on 2nd August.
- The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August.
- Unemployment at a 43 year low of 4%
- EU growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018.
- USA growth has risen from 2.2% in the first quarter to 4.2% in quarter 2.

4.2 The Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, though this will depend on whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

4.3 The CPI rose but is expected to fall back to the 2% inflation target over the next two years. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track.

4.4 The labour market, unemployment has continued at a 43 year low.

4.5 USA - The recent tax cuts is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019.

4.6 EU - In the EU, growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

Economic Forecast

4.7 The Council's treasury advisor, Link Asset Services (LAS), has provided the following interest rate forecast:

Table 1 – Interest Rate Forecasts

	Dec-18 %	Mar-19 %	Jun-19 %	Sep-19 %	Dec-19 %	Mar-19 %	Jun-20 %
Bank Rate							
Link	0.75	0.75	0.75	1.00	1.00	1.00	1.25
Capital Eco.	0.75	0.75	1.00	1.00	1.25	1.25	1.25
5yr PWLB Rate							
Link	2.00	2.10	2.20	2.20	2.30	2.30	2.40
Capital Eco.	1.70	1.70	1.90	2.20	2.40	2.40	2.40
10yr PWLB							
Link	2.50	2.50	2.60	2.70	2.70	2.80	2.90
Capital Eco.	2.10	2.10	2.30	2.60	2.80	2.80	2.80
25yr PWLB							
Link	2.90	3.00	3.10	3.10	3.20	3.30	3.30
Capital Eco.	2.60	2.60	2.90	3.10	3.40	3.40	3.40
50yr PWLB							
Link	2.70	2.80	2.90	2.90	3.00	3.10	3.10
Capital Eco.	2.40	2.40	2.70	2.90	3.20	3.20	3.20

4.8 Since the August increase the MPC emphasised, that future Bank Rate increases would be gradual. The Council's advisors think that the MPC will not increase Bank Rate in February 2019, ahead of the deadline in March for Brexit, but is likely to wait until August 2019.

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 for 2018/19 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 will aim 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 counterparty investment list (Appendix 3). Following the global financial crises and persistent uncertainties, the Council remains relatively risk averse and operates a restricted counterparty investment 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. Royal Bank of Scotland
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

5.4 The Council's temporary investment and borrowing activity (that is 365 days or less) over the period is set out below:

Table 2: Overall Treasury Cash Flow Position as at 30 September 2018

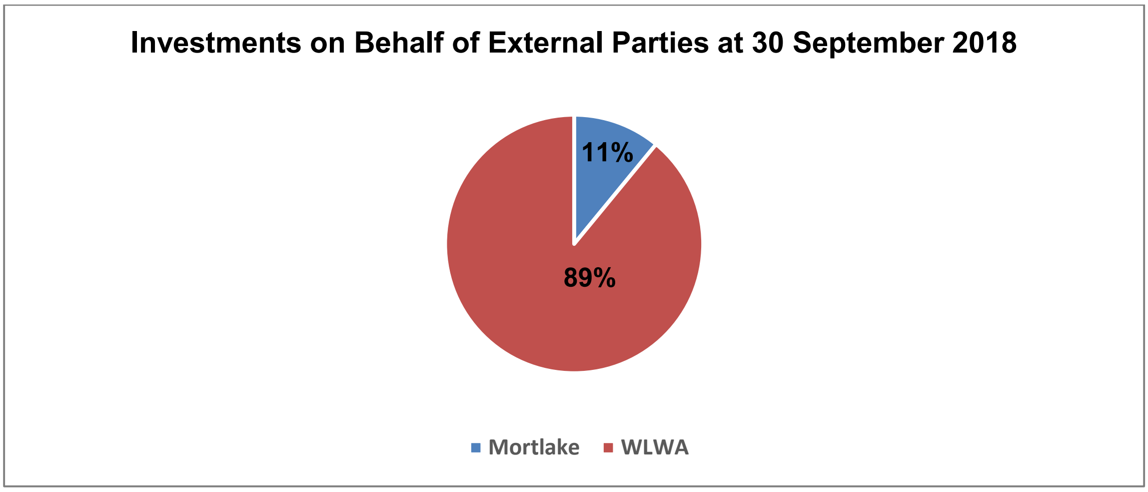
Description	Investments	Borrowing	Net Position
	£m	£m	£m
Outstanding 1 April 2018	93.790	(10.000)	83.790
Raised during period	666.380	0.000	666.380
Repayments during period	(628.760)	10.000	(618.760)
Outstanding 30 September 2018	**131.410**	**0.000**	**131.410**

5.5 Over the period to 30 September 2018, the Council's cash flows were maintained through borrowing and investment activities on the wholesale money market and the net investment position at the reporting date was £131.410m.

5.6 No additional borrowing was raised during the period to cover short term cash flow requirements. In September, TRIB agreed a reclassification of £10.000m temporary borrowing raised for just under one year as long term borrowing for reporting purposes.. This borrowing was outstanding at 30 September 2018.

Investments Held on Behalf of External Parties

5.7 The Council has an agreement with West London Waste Authority (WLWA) and the Board of Mortlake Crematorium to invest funds on behalf of the organisations. The total funds under the arrangement at 30 September 2018 were £19.092m (WLWA is £17.000m and Mortlake £2.092m) as shown below.



Investments held by the Council

5.8 The Council maintained an average balance of £124.1m of internally managed funds and held an outstanding balance of £131.4m as at 30 September 2018. The internally managed funds earned an average rate of 0.865%. The comparable performance indicator is the average 7-day LIBID rate, which returned 0.312% during the same period. This is illustrated in the table below.

Table 3: Performance vs Benchmark

Month	Council Performance	Benchmark Rate (7day LIBID rate)	Outperformance
April 2018	0.516%	0.210%	0.306%
May 2018	0.584%	0.210%	0.374%
June 2018	0.671%	0.210%	0.461%
July 2018	0.765%	0.360%	0.405%
August 2018	1.114%	0.440%	0.674%
September 2018	1.542%	0.440%	1.102%
Average	**0.865%**	**0.312%**	**0.554%**

5.9 The Council's total investments held at 30 September 2018 are outlined below:

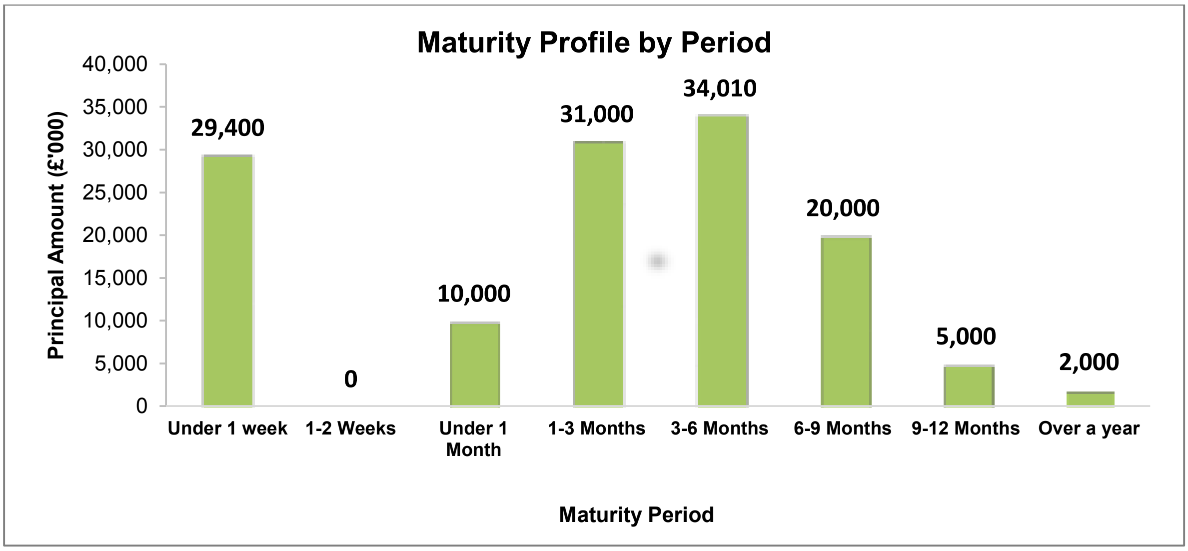
Table 4: Treasury Investment Portfolio

Counterparty Name	Total Investment as at 31/03/2018	Total Investments at 30/09/2018
	£m	£m
Local authorities	49.500	81.000
HSBC	30.000	-
Lloyds	13.670	6.000
Standard Chartered Bank	-	5.000
Nationwide Building Society	-	15.000
Barclays	-	-
Debt Management Office	-	-
Money Market Funds	-	24.400
Other	0.620	0.010
Total Investments	**93.790**	**131.410**

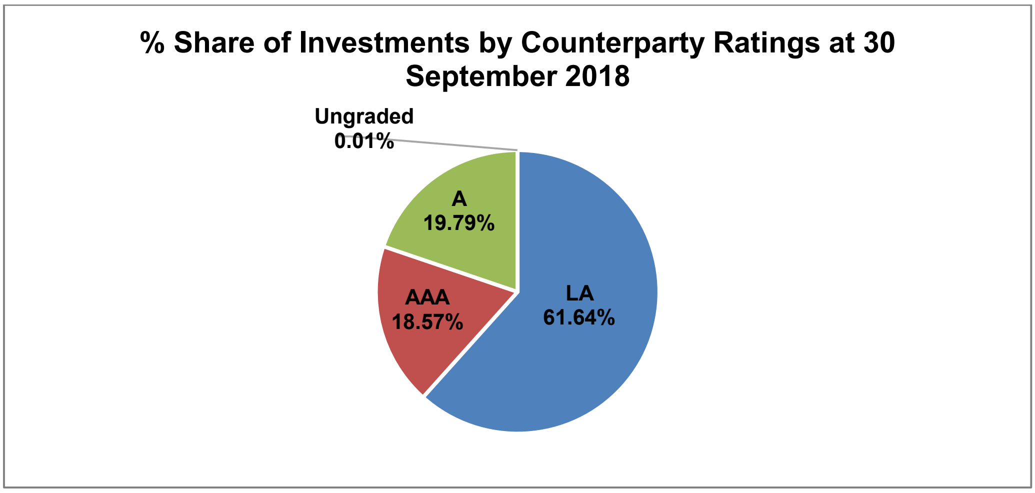
- *£0.010m in Ealing Community Resource Centre Ltd.*

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

5.11 The Council continues to place investments with several local authorities which are considered to be of high credit quality and are therefore on the Council's approved list of counterparties. The Council had 18 investments placed across several local authorities to the sum of £81.000m. These are included in the maturity profiling below:



- *The Council currently has one investment that has a maturity period of over one year –*



- *Ungraded includes Ealing Community of 0.01% A – Fitch credit rating*

5.12 The Council's counterparty list includes Money Market Funds (MMFs) 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 Value (NAVs) 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.

5.13 This does mean that the authority 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 September 2018, the outstanding balance of MMFs investments was £24.4m.

5.14 There are some changes to the rules around MMF's (due 2019) which will mean that the constant Net Asset Value (NAV) MMF which we currently invest in will no longer be available. There will be three types of funds, a Variable NAV, a public debt constant NAV and a Low Volatility NAV money market fund.

6 Long Term Borrowing Requirement and Debt

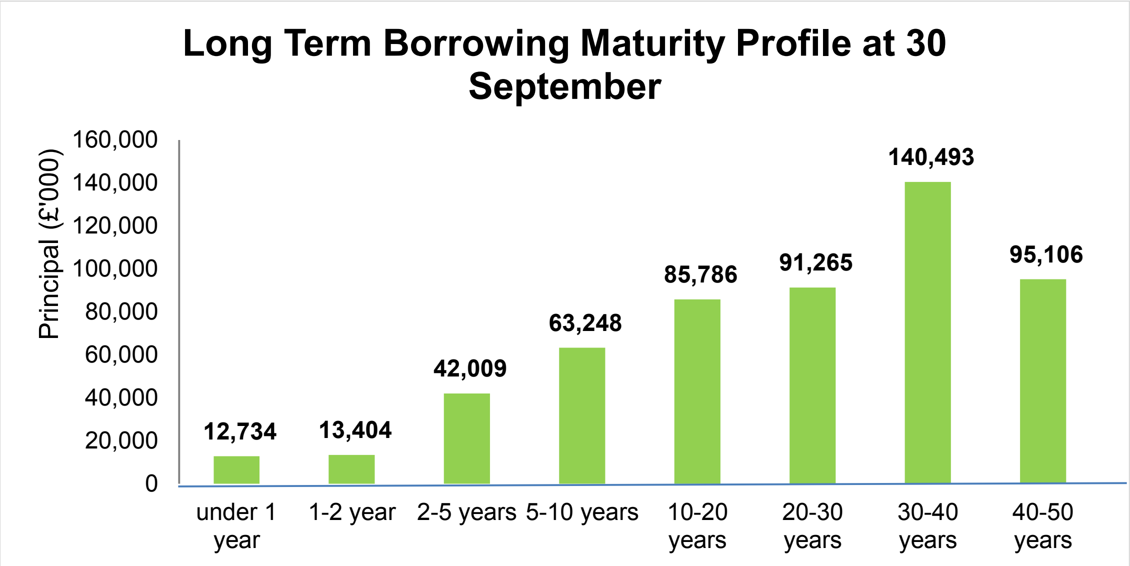
6.1 The Council's Treasury Management Strategy Report approved in February 2018 outlined the Council's long term borrowing strategy for the financial year 2018/19. Over the course of the reporting period, the Council's cash flow requirements were financed through internal borrowing.

6.2 The total long term borrowing at 30 September 2018 was £546.138m (including Mortlake Crematorium Board Loan). The following table shows the split between General Fund and HRA borrowing. There were no maturities and £15.000m additional PWLB loans was raised in the reporting period as shown below:

Table 5: External Debt

Source	Debt as at 31/03/18	Loans raised	Loans repaid	Debt as at 30/09/2018
	£m	£m	£m	£m
General Fund				
PWLB	320.916	10.000	-	330.916
Market Loans	62.016	-	-	62.016
*Mortlake Crematorium	1.918	0.175	-	2.093
WLWA	17.00	-	-	17.00
Total General Fund	**401.850**	**10.175**	**0.000**	**422.025**
HRA				
PWLB	120.129	5.000	-	125.129
Market Loans	25.984	-	-	25.984
Total HRA	**146.113**	**0.000**	**0.000**	**151.113**
Total Long Term Borrowing	**547.963**	**15.175**	**0.000**	**573.138**
**Memo Item:				
Other Long Term Liabilities (OLTL)	**119.552**	**-**	**0.000**	**115.185**

Notes:
**The £0.175m 'loan raised' figure relates to monies which are transferred by Mortlake Crematorium Board for investment by the Council on the Board's behalf*
***Other Long Term Liabilities (OLTL) 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.*



6.3 The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR). The Council's actual borrowing at the end of the quarter was within the anticipated year end CFR of £810.915m. The table below shows the breakdown of the Council's total CFR.

Table 6: Capital Financing Requirement for 2018/19

Capital Financing Requirement	2017/18 Actual	2018/19 Estimate
	£m	£m
CFR - General Fund	495.625	532.929
CFR - Housing Revenue Account	162.800	162.801
Other Long Term Liabilities - PFI	119.551	115.185
Total CFR	**777.976**	**810.915**

Debt Rescheduling

6.4 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. 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 following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010.

6.5 There were no debt rescheduling opportunities in the reporting period, as the cost of premium to repay debt outweighed savings that could be achieved from the lower PWLB borrowing rates.

PWLB Certainty Rate

6.6 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 local authorities to borrow at a discount of 0.20% on the Standard Rate. The Council has once again successfully reapplied to borrow at the preferential certainty rate for the financial year 2018/19.

7. Treasury Management Update Outside the Reporting Period

7.1. Additional PWLB loans of £5.000m was raised outside the reporting period in October.

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 the senior management team, the portfolio holder for Finance and the Treasury Risk and Investment Board (TRIB) which is chaired by the Executive Director of Corporate Resources.

8.3 The purpose of these reporting arrangements is to ensure that those with the ultimate responsibility for the Treasury Management function have an appreciation of the implications of treasury management policies and activities, and that those implementing the policies and executing transactions have properly fulfilled their responsibilities with regards to delegation and reporting.

9. Financial implications

9.1 The Treasury Management outturn position has continued the trend of recent years, with lower financing costs and reduced spending mainly attributable to deferred borrowing and some slippage on the capital programme. However, with current market conditions starting to shift, the borrowing position is under constant review and the Council will consider new borrowing at appropriate times. The current forecast for 2018/19 shows finance costs 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 investment 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 the code of practice contained in the document entitled "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" published by CIPFA, as amended or reissued from time to time.

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 2018 and the PWLB borrowing was monitored throughout the year, the budgeted rate for 2018/19 was 3.50%. 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 an investment list and receiving advice from Link 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 continues to be alert to concerns regarding the current Eurozone debt situation (e.g. Portugal, Ireland, Greece, Spain and Italy) and this is reflected in the Council's Counterparty Investment List.

14 Links to Strategic Objectives

14.1 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.

15 Consultation

15.1 Link Asset Services provides the Council with advice on treasury management.

16 Appendices

16.1 Appendix 1 – Investment in Local Authorities
Appendix 2 – Prudential Indicators Mid-year Outturn 2018/19
Appendix 3 – LB Ealing Counterparty Investment List – Private & Confidential

17 Background Information

17.1 Investment and borrowing activity files are kept at Perceval House on the 5th Floor.

Consultation

Name of Consultee	Department	Date sent to consultee	Date response received	Comments appear in report para:
Ross Brown	Director of Finance (Deputy S151)	15/11/2018	15/11/2018	Throughout
Maria Campagna	Head of Corporate Finance	15/11/2018		
Paddy Quill Helen Harris	Legal	14/11/2018	16/11/2018	
Cllr Bassam Mahfouz	Portfolio Holder for Finance & Leisure	15/11/2018		
Cllr Tim Murtagh	Chair, Audit Committee	15/11/2018		

Report History

Decision type: For Action/Information	Urgency item? No

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
	12/11/2018	19/11/2018	

Report no.:	Report author and contact for queries:
	Bridget Uku, Group Manager - Treasury & Investments ext 5981 Nina Bharj, Treasury & Investments Accountant ext 6715

Glossary of terms used in the report

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

Counterparties – Organisations the Council investments its surplus money with e.g. Banks; Local Authorities and MMFs.

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 – A 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.

GDP – Gross Domestic Product; a measure of a country's economic growth.

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 reduces 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 which are available on 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 designated by the Bank of England, whose main role is to regulate interest rates.

MRP – The Minimum Revenue Provision 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.