AUD223
AUDIT COMMITTEE

REPORT TITLE: TREASURY MANAGEMENT MID YEAR MONITORING REPORT FOR 2018/19

29 NOVEMBER 2018

REPORT OF PORTFOLIO HOLDER: Finance – Cllr. Guy Ashton

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WARD(S): ALL WARDS

PURPOSE

This report provides detail of the performance of the treasury management function. This includes the effects of the decisions taken in the past six months, and confirmation that there were no instances of non-compliance with the Council's Treasury Management Policy Statement and Treasury Management Practices, for 2018/19 to date.

RECOMMENDATIONS:

That the Audit Committee:

1. Note the Treasury Management Mid Year Monitoring Report 2018/19.

IMPLICATIONS:

1 COUNCIL STRATEGY OUTCOME

1.1 Treasury management is an integral part of helping the deliver the Council Strategy and all of its outcomes. The Council set a target of achieving a 1% return on its investments in 2018/19 and to date has achieved a return of 1.10%.

2 FINANCIAL IMPLICATIONS

2.1 Effective treasury management ensures both the financial security and liquidity of the Council.

3 LEGAL AND PROCUREMENT IMPLICATIONS

3.1 None

4 WORKFORCE IMPLICATIONS

4.1 None

5 PROPERTY AND ASSET IMPLICATIONS

5.1 None

6 CONSULTATION AND COMMUNICATION

6.1 This report has been produced in consultation with Hampshire County Council's Investments & Borrowing team.

7 ENVIRONMENTAL CONSIDERATIONS

7.1 None

8 EQUALITY IMPACT ASSESSEMENT

8.1 None

9 DATA PROTECTION IMPACT ASSESSMENT

9.1 None required

10 RISK MANAGEMENT

Risk	**Mitigation**	**Opportunities**
Returns from investments are too low	A diversified strategy that attempts to manage the balance between liquidity risk, credit risk and yield within the Council's risk	Returns above budgeted levels

Risk	Mitigation	Opportunities
	appetite.	
A counterparty fails	A diversified strategy that has relatively low levels of counter-party risk	
Cash is not available	A balanced portfolio of liquid and long term funds are held to ensure cash is available to utilise. The Council also mitigates this risk through cashflow forecasting	More accurate and immediate cashflow forecasting can help improve the return on investments through more active treasury management activity

11 SUPPORTING INFORMATION:

12 Introduction

12.1 The Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes receiving treasury management semi-annual and annual reports. This report fulfils the Council's legal obligation to have regard to the CIPFA Code.

13 Summary

13.1 The Council's Treasury Management Strategy (TMS) for 2018/19 was approved at a meeting of the Council in February 2018. The Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's TMS.

13.2 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England the Ministry of Housing, Communities & Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.

13.3 The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 22 February 2018.

13.4 Treasury management in the context of this report is defined as:

"The management of the organisation'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."

13.5 Hampshire County Council's Investments & Borrowing Team has been contracted to manage the Council's treasury management balances since September 2014 but overall responsibility for treasury management remains with Winchester City Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

13.6 All treasury activity has complied with the Council's TMS and Investment Strategy for 2018/19, and all relevant statute, guidance and accounting standards. In addition the Council's treasury advisers, Arlingclose, provide support in undertaking treasury management activities. The Council has also complied with all of the prudential indicators set in its TMS.

14 External Context

14.1 The following sections outline the key economic themes currently in the UK against which investment and borrowing decisions have been made to date in 2018/19.

Economic Commentary

14.2 UK Consumer Price Inflation (CPI) index fell to 2.4% in June, a 12-month low, as the effects of sterling's large depreciation in 2016 began to fade. However CPI ticked back up marginally to 2.5% in July, mostly due to higher energy prices, and up again to 2.7% in August from cultural services, where theatre admission prices rose by more than a year ago, and games, toys and hobbies, where prices for computer games rose this year but fell a year ago. The most recent labour market data for July 2018 showed the unemployment rate at 4%; the lowest since 1975. The three month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9%. However, real wages (i.e. adjusted for inflation) grew only by 0.4%, a marginal increase unlikely to have had much effect for households.

14.3 The rebound in Gross Domestic Product (GDP) growth in Quarter 2 of 2018 to 0.4% confirmed that the weakness in economic growth in Quarter 1 was temporary and largely due to weather-related factors. The Bank of England made no change to monetary policy at its meetings in May and June; however, hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking the Bank Rate to 0.75%. No further change was made to monetary policy at the Bank of England's meeting in September.

Credit Background

14.4 The big four UK banks are progressing well with ringfencing. Barclays Bank PLC and HSBC Bank PLC have created new banks (Barclays Bank UK and HSBC UK Bank) and transferred ringfenced (retail) business lines into the new companies. Lloyds Bank PLC has created Lloyds Bank Corporate Markets as a new non-ringfenced (investment) bank. RBS has renamed existing group entities and transferred accounts to leave NatWest Markets as the non-ringfenced bank and NatWest Bank, Royal Bank of Scotland and Ulster Bank as the ring-fenced banks. The Council's day-to-day banking contract remains with NatWest Bank.

15 Local Context

15.1 At 31 March 2018 the Council had net borrowing of £136.7m arising from financing its housing programme. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/18 Balance £m
General Fund CFR	(13.2)
Housing Revenue Account CFR	(164.0)
Total CFR	(177.2)
Less: Resources for investment	40.5
Net borrowing	(136.7)

15.2 The Council's current strategy is to maintain external borrowing below the underlying need by making use of resources available for investments, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 30 September 2018 and the movement since 31 March 2018 is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %
Long-term borrowing	(156.7)	-	(156.7)	(3.30)
Short-term borrowing	-	-	-	-
Total borrowing	(156.7)	-	(156.7)	(3.30)
Long-term investments	17.9	0.6	18.5	1.91
Short-term investments	19.8	(1.4)	18.4	0.74
Cash and cash equivalents	2.8	17.1	19.9	0.69
Total investments	40.5	16.4	56.9	1.10
Net external borrowing	(116.2)	16.4	(99.8)	

Note: the figures in the table above as at 31 March 2018 are from the balance sheet in the Council's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

15.3 The increase in total investments since 31 March 2018 shown in Table 2 reflects the annual position of 31 March being the lowest point for investment balances, due to many government grants being front-loaded. A significant part of the increase in cash and cash equivalents has been intentional due to a forthcoming major acquisition and to mitigate against the need to undertake short-term borrowing.

16 Borrowing Activity

16.1 As shown in Table 2, at 30 September 2018 the Council held £156.7m of loans, with the vast majority of the loans being in relation to the refinancing resettlement of the HRA in 2012. The mid-year treasury management borrowing position and movement since 31 March 2018 is shown in Table 3 below.

Table 3: Borrowing Position

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %	30/09/2018 WAM* years
Public Works Loan Board	156.7	-	156.7	3.30	22.10
Total borrowing	156.7	-	156.7	3.30	22.10

* Weighted average maturity

Note: The figures in the table above as at 31 March 2018 are from the balance sheet in the Council's statement of accounts, but adjusted to exclude accrued interest.

16.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective.

16.3 In keeping with these objectives, no new borrowing was undertaken in the period. This strategy enabled the Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

16.4 The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Council with the monitoring of internal and external borrowing.

16.5 At the Conservative party conference, the Prime Minister announced the government's intention to lift the Housing Revenue Account debt cap which limited the HRA's ability to borrow. Since the conference, the Ministry of Housing, Communities & Local Government (MHCLG) confirmed that the cap was lifted with effect from 30 October 2018. This will allow the Council to undertake increased borrowing in order to deliver its housing programme should it prove prudent to do so.

17 Investment Activity

17.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. The Council's investment holding was £56.9m at 30 September 2018, which was £3.8m (7%) higher than the same time last year. During the six month period from 1 April to 30 September 2018, the Council's investment balance ranged between £38.7m and £67.6m due to timing differences between income and expenditure. Table 4 below shows investment activity for the Council as at 30 September 2018 in comparison to the reported position as at 31 March 2018.

Table 4: Investment Position (Treasury Investments)

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %	30/09/2018 WAM* years
Short term investments					
Banks and Building Societies:					
- Unsecured	4.9	4.9	9.8	0.71	0.14
- Secured	5.0	(1.0)	4.0	0.87	0.33
Money Market Funds	0.9	16.2	17.1	0.68	0.00
Local Authorities	6.5	(5.0)	1.5	0.65	0.30
Corporate Bonds	4.0	0.9	4.9	0.69	0.20
Cash Plus Funds	-	1.0	1.0	0.68	n/a
	21.3	17.1	38.4	0.71	0.11
Long term investments					
Banks and Building Societies:					
- Secured	5.0	2.0	7.0	0.94	2.70
Local Authorities	8.0	(1.5)	6.5	0.86	1.69
	13.0	0.5	13.5	1.04	2.21
High yield investments					
Pooled Property Funds**	5.0	-	5.0	4.27	n/a
	5.0	-	5.0	4.27	n/a
TOTAL INVESTMENTS	39.4	17.5	56.9	1.10	0.67

* Weighted average maturity

** The rate provided for pooled property fund investments is reflective of the average of the most recent dividend return as at 30 September 2018

Note: the figures in the table above are from the balance sheet in the Council's statement of accounts, but adjusted to exclude operational cash and accrued interest.

17.2 Both the CIPFA Code and Government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

17.3 During the first half of 2018/19, total investment balances increased by £17.5m, which is in line with what is expected at this point in the year; this is due to the receipt of council tax, as well as the receipt of front-loaded grant. £16.2m of this balance is currently invested in money market funds to provide sufficient liquidity allowing for an imminent payment in relation to a major acquisition, as well as to meet the obligations of in month regular payments.

17.4 Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2018/19.

17.5 Counterparty credit quality was assessed and monitored with reference to credit ratings, for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

17.6 The Council will also consider the use of secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

17.7 The Council maintained a sufficient level of liquidity through the use of call accounts and money market funds. The Council sought to optimise returns commensurate with its objective of security and liquidity. The UK Bank Rate increased by 0.25% to 0.75% in August 2018 and short term money market rates have remained at relatively low levels which continued to have a significant impact on cash investment income.

17.8 The progression of credit risk and return metrics for the Council's investments managed in-house (excluding pooled funds) are shown in the extracts from Arlingclose's investments benchmarking in Table 5 below.

Table 5: Investment Benchmarking (investments managed in-house)

	Credit Rating	Bail-In Exposure	WAM* (days)	Rate of Return
31/03/2018	AA	17%	441	0.72%
30/09/2018	AA+	50%	248	0.72%
Similar LAs	AA-	56%	88	0.78%
All LAs	AA-	60%	37	0.76%

* Weighted average maturity

17.9 In Table 5 above, the bail-in exposure of the Council's investments that are managed in-house has increased (though is still lower than other LAs) and the weighted average maturity of these investments has reduced when comparing the position at 30 September to 31 March 2018 – this is a direct result of the requirement to keep a large proportion of funds liquid due to an impending major acquisition. It should be noted however that the increased cash position has been held in Money Market Funds (MMFs) which are invested in a diversified basket of holdings thus mitigating against the risk of holding substantial sums with individual counterparties. This has also resulted in a rate of return which is marginally lower in comparison to both similar local authorities and all local authority clients of Arlingclose.

17.10 The Council has targeted a proportion of funds towards high yielding investments as shown in Table 4. Investments yielding higher returns will contribute additional income to the Council, although some come with the risk that they may suffer falls in the value of the principal invested.

17.11 The £5m investment in an externally pooled property fund generated an average total return of 7.42%, comprising 4.41% income return which is used to support services in year, and 3.01% of capital growth. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed.

17.12 Investment in pooled vehicles allows the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. The funds, which are operated on a variable net asset value (VNAV) basis, offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. The Council's pooled fund investment is in the fund's distributing share class which pays out the income generated. The Council's intention is to hold this for at least the medium term.

17.13 MHCLG released a consultation on statutory overrides relating to the introduction of IFRS 9 Financial Instruments accounting standard from 2018/19. The consultation recognises that the requirement in IFRS 9 for certain investments to be accounted for a fair value through profit and loss may introduce "more income statement volatility" which may impact on budget calculations. The consultation proposes a time-limited statutory override and has sought views whether it should be applied only to pooled property funds. The Council has responded to the consultation which closed on 30 September. The Council's response stated that the Council agrees that there should be a statutory override, but that it should not be time limited, as the circumstances meaning an override is appropriate now will still apply in April 2021 and beyond. The statutory overrise should apply to all pooled investment funds, as the Council sees no reason for the Government to incentivise property funds over other pooled funds.

18 Non-Treasury Investments

18.1 Although not classed as treasury management activities, the 2017 CIPFA Code now requires the Council to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons.

18.2 The total value of investments properties as at 31 March 2018 was £47.7m (£46.4m as at 31 March 2017). Net rental income after costs to the end of September 2018 amounted to £1.0m representing a yield of 4.2% to date (3.9% average yield in 2017/18).

18.3 In addition to investment properties, the Council invested £1.6m in the purchase of Coventry House. A short-term lease of the asset is anticipated to make a return of £95,000 in 2018/19 and the redevelopment of the site as a car park is planned for the future.

19 Compliance Report

19.1 The Council confirms compliance of all treasury management activities undertaken during the period with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits, as well as the authorised limit and operational boundary for external debt, is demonstrated in Tables 6 and 7 below.

Table 6: Debt Limits

	2018/19 Maximum £m	30/09/2018 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	156.7	156.7	210.5	212.7	✓
Other long term liabilities	0.2	0.2	0.2	0.3	✓
Total debt	156.7	156.7	210.7	213.0	✓

Table 7: Investment Limits

	2018/19 Maximum	30/09/2018 Actual	2018/19 Limit	Complied
Any single organisation, except the UK Central Government	£5m	£5m	£7m	✓
Any group of organisations under the same ownership	£5m	£5m	£7m	✓
Any group of pooled funds under the same management	£5m	£5m	£7m	✓
Money Market Funds	33%	30%	50%	✓

20 Treasury Management Indicators

20.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

20.2 This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal invested will be:

Table 9: Interest Rate Exposures

	30/09/2018 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate investment exposure	£8.5m	£20m	✓
Upper limit on variable interest rate investment exposure	£48.4m	£100m	✓
Upper limit on fixed interest rate borrowing exposure	£156.7m	£213m	✓
Upper limit on variable interest rate borrowing exposure	£0m	£213m	✓

20.3 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing

20.4 This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 10: Maturity Structure of Borrowing

	30/09/2018 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0%	25%	0%	✓
12 months and within 24 months	0%	25%	0%	✓
24 months and within 5 years	3%	25%	0%	✓
5 years and within 10 years	22%	25%	0%	✓
10 years and within 20 years	32%	50%	0%	✓
20 years and within 30 years	13%	50%	0%	✓
30 years and within 40 years	13%	75%	0%	✓
40 years and within 50 years	17%	100%	0%	✓

Principal Sums Invested for Periods Longer than 365 days

20.5 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

Table 11: Principal Sums Invested for Periods Longer than 365 days

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£18.5m	£10.5m	£7.0m
Limit on principal invested beyond year end	£20m	£20m	£20m
Complied	✓	✓	✓

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

AUD119: Treasury Management Practices, 22 June 2015

CAB3013: Treasury Management Strategy 2018-19, 14 February 2018

CAB3064: Treasury Management Outturn 2017/18, 18 July 2018

AUD197: Treasury Management Mid-Year Review 2017/18, 28 September 2017

Other Background Documents:-

None

APPENDICES:

None